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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and
R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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QUESTIONS PRESENTED

1. Does SEC Rule 10b–5 impose criminal sanctions on a newspaper columnist for "misappropriating" his newspaper's publication schedule as part of a scheme to trade certain securities, where the newspaper is the only alleged victim of fraud and has no interest in the securities traded?

2. Should this Court reject the expansion of the mail and wire fraud statutes to cover breaches of purely private work-rules, intangible injuries, and incidental mailings and wirings?

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NO. 86–

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

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UNITED STATES OF AMERICA,

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Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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Petitioners respectfully request that writ of certiorari be issued to review a decision of the United States Court of Appeals for the Second Circuit, entered on May 27, 1986, which affirmed (by a divided vote) petitioners' convictions of securities fraud, mail and wire fraud, and conspiracy, in connection with their "misappropriation" of the Wall Street Journal's publication schedule.

OPINIONS BELOW

The opinion (per Pierce, J., and Mansfield, J.) and dissenting opinion (per Miner, J.) of the Court of Appeals are reported as *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), and are reprinted in the Appendix to this petition, *infra*, at 1a–29a.[1] The decision of the United States District Court for

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1. Citations to the Appendix to this petition are denoted by a lower-case "a" following the page number ("___a"). Citations to the appendix submitted to the Court of Appeals are denoted as "A___"; citations to the transcript of proceedings in the district court as "T.___"; and citations to trial exhibits as "Exh. ___."

the Southern District of New York, reported as *United States v. Winans*, 612 F. Supp. 827 (S.D.N.Y. 1985) (Stewart, J.), is reprinted in the Appendix to this petition, *infra*, at 33a–73a.

JURISDICTION

The decision of the United States Court of Appeals for the Second Circuit, from which review is sought, was entered on May 27, 1986. With a minor exception,[2] that decision affirmed judgments of conviction that were entered on August 6, 1985 against petitioners in the United States District Court for the Southern District of New York, after a twenty–day non–jury trial before the Honorable Charles E. Stewart, Jr. Petitions for rehearing, with suggestions for rehearing en banc, were denied on July 17, 1986. This Court has jurisdiction to review the judgments of the Court of Appeals under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Title 18, United States Code

§ 371. Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

* * *

2. The Court of Appeals reversed the conviction of petitioner R. Foster Winans on certain counts which were based upon certain securities transactions between petitioner Kenneth P. Felis and a third party.

§ 1341. Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

* * *

§ 1343. Fraud by wire, radio, or television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

Title 15, United States Code

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or

of the mails, or of any facility of any national securities exchange —

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 Code of Federal Regulation

§ 240.10b–5. Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case presents the Court with the opportunity to resolve highly significant questions regarding the scope of the securities laws that were expressly left open by the Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), and that divided the Court of Appeals in this case. Here, the Court of Appeals, in purported application of the unsettled

"misappropriation" theory of securities fraud, extended Securities and Exchange Commission ("SEC") Rule 10b–5 "beyond all reasonable bounds," 791 F.2d at 1037, 28a (Miner, J., dissenting), so as to redress not any alleged fraud on securities investors, but a potential injury to a newspaper's reputation.

This case also presents the Court with the opportunity to review the recent and much criticized "extraordinary expansion of the mail and wire fraud statutes"[3] and to resolve an apparent split among the circuits regarding the outer limits of that expansion. Here, the Court of Appeals, going beyond the limits set by some other circuits, approved the imposition of federal criminal penalties for an employee's infraction of his employer's private workrules, even though the rules had no analogue in public law or generally accepted industry standards, even though the sole harm allegedly caused by the infraction was to the employer's reputation, and even though the federal mailings and interstate wirings on which the charges were predicated bore no relation whatever to the infraction itself.

The facts of the case are set forth in detail in the specific findings of the district court, 612 F. Supp. at 829–38, 35a–50a, and are summarized by the Court of Appeals, 791 F.2d at 1026–27, 5a–7a. In essence, the case centers on the conduct of petitioner Winans from August 1982 through March 1984, when he was a reporter for the Wall Street Journal (the "Journal") and one of the writers of "Heard on the Street" ("Heard"), a daily market gossip column which focused on the movements and prospects of various stocks. The Heard column did not purport to give investment advice, and the Journal did not view or present the column as giving such advice to readers.[4] The Journal's wide readership and the column's popularity,

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3. *United States v. Weiss*, 752 F.2d 777, 791 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) (Newman, J., dissenting).

4. The Journal, a newspaper of general circulation, does not fall within the coverage of the Investment Advisors Act. *See* 15 U.S.C. § 80b–2(a)(11)(D). Neither the SEC nor any other regulatory agency has ever suggested the contrary (T. 50, 396–97).

however, tended to give the column a short-term impact upon the market price of stocks mentioned in the column.

Winans' columns never contained either corporate "inside" information or "hold-for-release" information given to the Journal for dissemination to the public at a subsequent time (T. 2459-60). The district court expressly found that "Winans was not a temporary insider [of the corporations he wrote about], did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information." 612 F. Supp. at 841, 56a. "In terms of the securities laws," the district court continued, "neither Winans nor the Wall Street Journal owed any duties at all to the corporations that were the subject of *Heard* columns or to the shareholders of those corporations." *Id.*

"Sources" who gave information to Winans for his column were free to trade at any time upon the information or the prospect of its publication in the Journal — and did so (T. 1881). Nevertheless, the courts below held that *Winans'* trading in securities on the basis of his knowledge of when Heard columns containing such information were scheduled to appear, and his prepublication disclosure of these schedules to others who also traded in the subject securities, constituted "securities fraud," solely because such use of the publication schedules was prohibited by the Journal's internal workrules regarding conflicts of interest. Specifically, a written conflicts of interest policy — contained at the back of a 40-page pamphlet given to new Journal employees — provided, among much else, that knowledge of forthcoming Journal articles was "deemed" to be the "property" of Dow Jones & Co., Inc. ("Dow Jones" — the owner of the Journal), that an employee could not buy or sell stocks if he was writing an article about the stock or knew of such an article by someone else which was to appear in the newspaper, and that an employee could not disclose the subjects of forthcoming articles to persons outside the newspaper.[5]

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5. Dow Jones never informed the Journal's readers of the existence of this internal policy until after the events of this case (Exh. WSJ-9; A110; T. 115-116, 159). In making that disclosure in a March 2, 1984 Journal

These rules were promulgated unilaterally by Dow Jones and were not contained in Dow Jones' collective bargaining agreement with Winans' union (Exh. WU–1, WU–2; T. 121; A100). Moreover, they were uniformly presented to employees as intended to go well beyond the requirements of the law, so as to avoid even a "misperception" of impropriety by outsiders (A112; T. 135–36, 231, 319, 1523). Nonetheless, it is the breach of these workrules that forms the lynchpin of the government's case here.[6]

In mid–October 1983, in violation of these rules, Winans agreed to disclose to stockbroker Peter Brant of Kidder, Peabody & Co., Inc. ("Kidder Peabody") the subject–matter (name of stock), general tenor (positive or negative) and probable publication date of forthcoming columns (T. 2078). At Winans' insistence, however, it was agreed that neither the accuracy nor the journalistic integrity of any article would be compromised, and this promise was fulfilled (T. 614, 877, 1883–85, 2079). With respect to the trades, Brant enlisted the assistance of petitioner Felis, Brant's colleague at Kidder Peabody, in whose account many of the trades were made. Under their arrangement, profits, if any, were to be split equally three ways (T. 2079–80).[7] Though Winans believed (correctly as it turned out) that discovery of this arrangement would result

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article entitled *Media Policies Vary on Preventing Employees and Others From Profiting On Knowledge of Future Business Stories*, the Journal reported that media policies concerning investments by reporters were the exception rather than the rule, and that the Journal's informal survey of media around the country showed that most newspapers and broadcasters had no policy at all.

6. At trial, the government expressly conceded that, in the absence of these rules, petitioners' conduct would not have violated the laws here employed. 612 F. Supp. at 842, 58a.

7. Petitioner Carpenter was not involved in any of these arrangements or in their execution, and was acquitted of the conspiracy charge based on them. Winans, however, unbeknownst to Brant and Felis, made a half–dozen small pre–publication trades in stocks he wrote about through a brokerage account that he opened in Carpenter's name. These resulted in total profits of $4,532.84. The 12 substantive securities, mail and wire fraud counts upon which Carpenter was convicted (as an aider and abetter) involved these trades.

in his dismissal from Dow Jones (T. 2228; Exh. GX-343 at 253-54), neither Winans, Brant nor Felis believed that they were acting illegally (T. 925, 1295, 1889).[8]

Though these facts were held to state a securities fraud, the sole alleged victim of the fraud charges was Dow Jones and not any securities investor. Moreover, Dow Jones was shown to have suffered no actual damage — tangible or reputational — and none was found by the district court.[9] Furthermore, neither the interstate wiring of Winans' (concededly accurate) articles from the Journal's offices in New York to its printing plant in Massachusetts, nor the subsequent mailings of the Journal to subscribers, were in any sense caused by the petitioners for any purpose whatever, let alone for the execution of their scheme; yet these wirings and mailings were held by the Court of Appeals to meet the statutory requirements of the mail and wire fraud statutes and to supply the requisite federal interest.

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8. Brant, who testified for the government at trial, pleaded guilty to conspiracy and securities fraud pursuant to an agreement with the government by the terms of which he must re-plead to other offenses if this Court disapproves the government's securities fraud theory.

9. Knowledge of Winans' arrangement with Peter Brant became public on March 29, 1984 (T. 106; Exhs. GX-38, 39). In the next quarter beginning April 1, 1984, Dow Jones' earnings, total revenues and advertising revenues all rose to record levels (T. 107, 252-57; Exh. W-A).

ARGUMENT

I.

Criminal Sanctions May Not Be Imposed On A Newspaper Columnist, Under SEC Rule 10b–5, For "Misappropriating" His Newspaper's Publication Schedule As Part Of A Scheme To Trade Certain Securities, Where The Newspaper Is The Only Alleged Victim Of Fraud And Has No Interest In The Securities Traded

In 1980, this Court "left for another day"[10] the question of whether an employee's unauthorized use, in purchasing securities, of information obtained by virtue of his employment constitutes securities fraud where he owes no duty to the seller. *Chiarella*, 445 U.S. at 235–36. Thereafter, the Second Circuit answered this question in the affirmative.[11] Now, in the instant case, the Second Circuit has taken this "misappropriation theory" of securities fraud, whose starting–point five years ago was the question reserved then and still not answered by this Court,[12] and extended it to a case having absolutely no bearing on the protection of the securities markets or investors. Petitioners urge that the day for review has now come, lest the lower courts continue the development of a body of law at odds with the language and intent of the Securities Exchange Act of 1934 ("1934 Act") and the recent teachings of this Court.

The extreme facts of this case make it one of first impression even for the Second Circuit, as the majority itself

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10. *Chiarella v. United States*, 445 U.S. 222, 238 (1980) (Stevens, J., concurring).

11. *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). *See also SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985).

12. *Cf. Bateman Eichler, Hill Richards, Inc. v. Berner*, 105 S. Ct. 2622 (1985).

expressly found. 791 F.2d at 1027, 8a. The only basis for the securities fraud convictions was the violation of a financial newspaper's internal corporate policy. The only alleged victim of the securities fraud was the same newspaper, which had absolutely no interest in the purchase, sale or value of any of the securities traded by petitioners. The only alleged harm from the securities fraud in this case was the potential injury to the newspaper's reputation. As the dissent stated, section 10(b) "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper." *Id.* at 1037, 29a (Miner, J., dissenting). Yet, that is the singular result of the holding below.[13]

In the Second Circuit's prior "misappropriation" cases (*Newman* and *Materia*),[14] there arguably existed a nexus between the fiduciary duties owed by the defendant–employees to their employers' market participant clients, the injuries to those market participants in their contemplated securities transactions, and the federal securities regulatory scheme.[15] The

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13. It was *not* part of the government's theory that Winans' articles were altered, or slanted, or falsified in any way in order to affect or manipulate the price of any stock. Nor were the articles "planted" for the purpose of "touting" or "publishing" any stock. As all parties agreed below, such conduct is proscribed under conventional theories of securities law which were not here invoked. *See, e.g.*, 15 U.S.C. § 77q(b).

14. *See supra* note 11; *infra* note 15.

15. The "misappropriation theory," as applied by the Second Circuit in *Newman* and *Materia* (and as hypothesized by this Court in *Chiarella*), was predicated upon breaches of the fiduciary duties owed by investment banks, financial printers and others similarly situated, and their respective employees, not to misappropriate confidential client information concerning proposed securities transactions such as tender offers. The victims of the misappropriations in *Newman* and *Materia* were market participants — corporations planning to engage in securities transactions in connection with contemplated tender offers. These market participants were injured in their securities transactions in that the defendants' conduct in *Newman* and *Materia* artificially inflated the "target company stock prices ... through purchases by purloiners of confidential information." *Newman*, 664 F.2d at 17. The misappropriated information was classic "market" information, i.e., information relating to the activities of investors, traders, brokerage firms, market–makers, and others involved in securities trading that affects the value of corporate securities.

tender offeror clients, who were injured in their securities transactions by a misappropriation of classic "market" information, were arguably intended beneficiaries of the securities laws.

The facts present in this case contrast starkly with those in prior "misappropriation" cases. As the lower courts found, Winans was not, by virtue of his position as an author of the Heard column, an insider of the corporations that were the subjects of his articles. Winans did not have a relationship with any of those corporations making him a "temporary insider," did not receive inside information in violation of any corporate insider's duty to his corporation's shareholders, and did not steal information from any corporate insider. *See Dirks v. SEC*, 463 U.S. 646 (1983). The only duty in this case was Winans' duty to his employer, Dow Jones, and that duty arose out of internal corporate workrules designed to safeguard a private corporation's concern for its reputation for journalistic integrity.[16] The criminality of Winans' conduct turned wholly upon the existence of a particular Dow Jones policy which the public had not even been told existed, which did not exist at most other newspapers, and which Dow Jones itself was free — legally — to ignore if it chose. Indeed, applying the "misappropriation theory" to a case in which there is no securities–related fiduciary duty or injury but only a breach of a non–securities–related internal corporate workrule gives rise to a legal anomaly: an employee commits securities fraud by trading on certain information, while his employer can trade on the very same information without violating the securities laws.[17] Yet,

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16. It is axiomatic that when an employee purloins confidential client information entrusted to his or her employer, the employer's reputation as a safe repository for client information will be implicated. But, although the reputations of the employers in *Newman* and *Materia* were found to have been harmed by their employees' misappropriations, these injuries alone did not support the application of the federal securities laws. It was the existence of duties to market–participant clients not to trade on their securities–related information that supported applications of the "misappropriation theory" in *Newman* and *Materia*.

17. Likewise, Winans could have purchased or sold securities based on advance knowledge of the publication schedules of his articles if he had been a "free–lancer" or if he had been writing for one of the majority of newspapers

from the perspective of the investor, and as concerns the securities markets, the impact of the employer's and employee's conduct is the same.[18]

The federal securities laws are not intended either to be a vehicle for the implementation of internal corporate policy or to uphold common–law agency principles that have traditionally been matters of state law. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), this Court held that violations of fiduciary duties affecting securities transactions registered under the 1934 Act are not actionable under section 10(b) when the duties fall within the arena of state law. The holding below, however, sweeps into the ambit of Rule 10b–5 any kind of fiduciary breach where securities are even tangentially involved, including, as here, silent infraction of a private company's workrules designed to safeguard reputation which have been specifically presented to employees as going beyond the requirements of the law.

The purpose of the federal securities laws is to protect investors, not reputations. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court noted that

> [f]ederal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929. The Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing . . . The 1934 Act was intended principally to protect

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which did not have comparable workrules.

18. The Second Circuit recognized but allowed this capricious incidence of criminal liability, speculating that Dow Jones would not want to effectuate transactions that could harm its own reputation. 791 F.2d at 1033, 20a. On this approach, the entire application of the securities laws turns on how finicky a private employer may be about preserving its reputation when tempted by fast, and legal, profits.

> investors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over–the–counter markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges.

Id. at 194–95 (citations omitted); *see* S. Rep. No. 47, 73d Cong., 1st Sess. (1933) (purpose of Securities Act of 1933 to protect investing public). Both the majority and the dissent in this case recognized this primary function of the federal securities laws. *See* 791 F.2d at 1032, 18a (citing *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 235 (2d Cir. 1974) (majority)); 791 F.2d at 1037, 29a (citing *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2d Cir. 1967) (dissent)).

But the lower courts' decision here affords securities investors not one whit of added protection. The ordinary investor has no way of knowing whether a newspaper columnist is barred by the publisher's internal rules from advance trading on the information contained in the column. Nor, to the actual purchasers and sellers of the securities traded by petitioners, is it relevant whether the transactions were made by the employee Winans or the employer Dow Jones.[19]

The information upon which petitioners traded is also insufficient as a predicate for application of the federal securities laws. The information contained in Winans' articles was not inside information but rather information "fully available to the

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19. Indeed, through its flawed overextension of the "misappropriation theory" in this case, the Court of Appeals has in essence exhumed the parity–of–information rule buried by this Court in *Chiarella*. Even more troubling, the majority's decision allows *private employers* to determine when the parity–of–information rule will apply. Dow Jones may, as a matter of internal corporate policy, declare that its employees must in effect follow the parity–of–information rule and refrain from trading on advanced knowledge of articles scheduled to appear in the Journal. But, for the Second Circuit to convict Winans for securities fraud where neither he nor his employer had any independent duty to these investors, allows the employer to declare unlawful what this Court has declared *not* to be unlawful.

public," 791 F.2d at 1037, 28a (Miner, J., dissenting), and information which Winans was free to use in trading securities (as the government conceded below). The only "inside" information involved in this case was Dow Jones' publication schedule of the Heard column. That publication schedule, however, had nothing to do with the value or investment worthiness of any of the stocks which were the subject of Winans' columns, and does not even rise to the level of "outside" or "market" information. As the dissent noted:

> To say that the "publication schedule" of the Wall Street Journal was the non–public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b–5 beyond all reasonable bounds. Knowledge of publication dates simply is not the special securities–related knowledge implicated in the misappropriation theory. Moreover, it cannot be said that the schedules were secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published.

Id., 28–29a. Basing criminal convictions on use of such information fails to afford securities investors one scintilla of added protection and does not in any way increase the integrity of the securities markets. Indeed, here, as in *Dirks*, the effect of the lower courts' decisions is, if anything, the opposite of what should be encouraged, since it provides an incentive to reporters to keep silent and trade on their acquired information, rather than to write articles about the information and, in so doing, preclude themselves from prepublication trading on the information. *See* 463 U.S. at 658.

Until the majority's decision in this case, Judge Miner continued, "the misappropriation theory of criminal liability for securities fraud was applied only in those cases involving the taking and use of non–public confidential *securities–related* information by those who obtain that information through special relationships with their sources of knowledge." 791 F.2d at 1036, 27–28a (emphasis in original) (citing *Materia* and

Newman). By using the federal securities laws to impose criminal penalties for breaches of internal corporate policy, the Second Circuit has caused tremendous confusion and doubt as to what types of relationships and what types of information are covered by section 10(b) and Rule 10b–5.[20] This unwarranted expansion of the securities laws does not enhance the integrity of the financial markets, may in fact discourage the prompt flow of important information to the public, and is a disservice to the rule of law.

II.

The Court Should Reject The Expansion Of The Mail And Wire Fraud Statutes To Cover Breaches Of Purely Private Workrules, Intangible Injuries, And Incidental Mailings And Wirings

The affirmance below of petitioners' mail and wire fraud convictions is a further, and major, step in the "recent...extraordinary expansion of the mail and wire fraud statutes"[21] to create, by judicial fiat, "a new crime — corporate improprieties — which entails neither fraud nor even a victim . . . ."[22] This recent trend, which has been the subject of a growing chorus of criticism from judges and scholars alike,[23] has never been approved by this Court. Moreover, it flies in the

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20. *See, e.g.*, Arkin, *Insider Trading, Distinguishing Unequal Advantage from Fraud*, N.Y.L.J., June 19, 1986, at 1, cols. 3–4; Herzel & Katz, *Insider Trading Cases: Right Result, Wrong Rules*, Legal Times, June 23, 1986, at 15; *Insider Trading: Outside Which Law?*, Economist, June 14, 1986, at 76; Karmel, *Market Information: Insider Trading*, N.Y.L.J., June 19, 1986, at 1, col. 1; Klein, *Winans Decision Defies Doctrinal Shift*, Legal Times, June 23, 1986, at 15; Lewin, *Some Assert S.E.C. Pushes Too Far*, N.Y. Times, July 21, 1986, at D–1, col. 3; Marcus, *Murky Inside–Trading Rules Often Point to Outsiders*, Washington Post, June 1, 1986; Obermaier, *Who's an Insider? What's Inside?*, N.Y.L.J., July 1, 1986, at 1, col. 1.

21. *Weiss*, 752 F.2d at 791 (Newman, J., dissenting).

22. *United States v. Siegel*, 717 F.2d 9, 24 (2d Cir. 1983) (Winter, J., dissenting).

23. *See* notes 55–57, *infra*.

face of the statutory language and contradicts this Court's earlier decisions construing these statutes.

On its face, the federal mail fraud statute, 18 U.S.C. § 1341, simply prohibits a person from using the mails for the purpose of executing a scheme to defraud. (The wire fraud statute, 18 U.S.C. § 1343, prohibits similar use of interstate wire communication, and identical principles govern the scope of the two statutes.)[24] When the mail fraud statute was enacted in 1872, the notion of fraud — defined at common law to cover only the obtaining of money or property by affirmatively false statements of existing facts — was sufficiently narrow that it required a decision of this Court[25] and an amendment by Congress[26] to make clear that the statute also reached the obtaining of money or property by false pretenses, representations, or promises as to the future.[27] Twice since then this Court has had occasion to caution against extending the statute beyond "pecuniary or property injury inflicted by a scheme to use the mails for the purpose."[28] Likewise, the Court has repeatedly reversed attempts to predicate mail fraud prosecutions on mailings that bear no purposeful relation to the fraudulent schemes in question.[29]

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24. *See, e.g., Siegel*, 717 F.2d at 14, and cases there cited.

25. *Durland v. United States*, 161 U.S. 306 (1896).

26. Act of March 4, 1909, ch. 321, § 215, 35 Stat. 1130.

27. *See* Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 811, 816 (1980); Comment, *The Intangible–Rights Doctrine and Political–Corruption Prosecutions Under The Federal Mail Fraud Statute*, 47 U. Chi. L. Rev. 562, 578 (1980). *See also United States v. Frankel*, 721 F.2d 917, 919–20 (3d Cir. 1983).

28. *Fasulo v. United States*, 272 U.S. 620, 628–29 (1926); *Hammerschmidt v. United States*, 265 U.S. 182, 189 (1924). *See also United States v. Curry*, 681 F.2d 406, 418 (5th Cir. 1982) (Garwood, J., concurring); *United States v. Caldwell*, 544 F.2d 691, 697 (4th Cir. 1976) (Widener, J., dissenting).

29. *United States v. Maze*, 414 U.S. 395 (1974); *Parr v. United States*, 363 U.S. 370, 389–94 (1960); *Kann v. United States*, 323 U.S. 88, 94 (1944). *See also United States v. Lane*, 106 S. Ct. 725, 733–34 (1986).

Yet, in the absence of more recent guidance from this Court, the lower courts have subjected the mail and wire fraud statutes to a vast judicial expansion — variously described as "extraordinary,"[30] "inexorable,"[31] and "seemingly limitless"[32] — that not only "eliminate[s] the need to show a substantial connection between the scheme to defraud and the use of the mails or wires...[but even] the need to show fraud" itself.[33] Where the statutes speak of a "scheme...to defraud," the lower courts have substituted a "breach of fiduciary duty."[34] Where the statutes speak of "obtaining money or property," the lower courts have substituted "deprivation of intangibles" such as "honesty," "loyalty," "privacy," "reputation," "time," "effort," or "expectations."[35] Where the statute speaks of a use of the mails that is for the "purpose" of executing the fraud, the lower courts have substituted a use of the mails that is a "reasonably foreseeable" accompaniment to the execution of the fraud.[36]

The instant case represents the culmination, and further extension, of these trends.

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30. *Weiss*, 752 F.2d at 791 (Newman, J., dissenting).

31. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

32. *Id.* at 14; *United States v. Margiotta*, 688 F.2d 108, 120 (2d Cir. 1982), *cert. denied*, 461 U.S. 913 (1983); *United States v. Von Barta*, 635 F.2d 999, 1001 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981).

33. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

34. *See, e.g., id.* at 14; *Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *United States v. Bronston*, 658 F.2d 920, 926 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982); *United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974); *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958).

35. *See, e.g., Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Von Barta*, 635 F.2d at 1005–06; *United States v. Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980); *United States v. Condolon*, 600 F.2d 7, 9 (4th Cir. 1979); *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Keane*, 522 F.2d 534, 544 (7th Cir. 1975), *cert. denied*, 424 U.S. 976 (1976).

36. *See, e.g., United States v. Green*, 786 F.2d 247 (7th Cir. 1986); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981).

First, this decision represents the clearest example to date of the substitution of a vacuous concept of "breach of fiduciary duty" for the statutory requirement of fraud. Specifically, the majority's opinion, while paying lip–service to the reassuring dictum that "not every breach of an employee's fiduciary duty to his employer constitutes mail or wire fraud,"[37] nonetheless holds that Winans' fraud consisted *solely* of his failure to disclose to his employer (the Wall Street Journal) that he had breached the Journal's private rules of confidentiality by disclosing its publication schedule in advance.[38] There is no principled distinction between this and any other breach of an employee's fiduciary duty to his employer, no matter how minor.

The implications of such a rule of law are staggering. Disobedience to any internal workrule may give rise to a mail fraud or wire fraud violation, no matter how technical the rule or trivial the conduct it prohibits, even where there is no discernible federal interest in regulating the employment relationship. Nor does it matter that the rule was imposed unilaterally by the employer,[39] had no obvious correlative either in public law[40] or

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37. 791 F.2d at 1035, 24a.

38. *Id.* The rules in question — convoluted, ambiguous, and technical — were hidden at the back of a 40–page pamphlet given to new Journal employees. It defies common sense that any new employee read them carefully, let alone remembered them. Moreover, even on their face, the rules did not separately require disclosure to the Journal of breaches of its confidentiality policy. Thus, even assuming Winans' prepublication use of the schedule was a "misappropriation" of information, 791 F.2d at 1034, 23a, his conduct did not violate any express "duty to disclose" that misappropriation to the Journal. Thus, his conduct is deemed fraudulent only because the Court of Appeals effectively holds that there is an *inherent* duty to disclose to one's employer a breach of that employer's workrules. This is precisely the "bootstrap" approach to mail fraud condemned in the Second Circuit's earlier opinion in *Newman*, 664 F.2d at 19.

39. The Journal's workrules were neither quoted nor referred to in the collective bargaining agreement governing Winans' employment (A100).

40. *See United States v. Pisani*, 773 F.2d 397, 410 (2d Cir. 1985) (mail fraud conviction reversed because alleged fraud was not prohibited by state statute).

even common industry practices,[41] and was made known to the employee (if at all) only after the employment was commenced.[42] Violation of the rule now constitutes grounds not only for discharge but also for a federal criminal prosecution. Indeed, even a non–employee who has no better than a "general awareness" of the workrule (Carpenter)[43] or no awareness whatever (Felis)[44] can be criminally prosecuted if he assists the employee in the activities that violate the workrule.

Thus, the decision below gives every employer the power to decide what acts are indictable as felonies and thereby usurps a role heretofore reserved to the legislature.[45] Even more dangerously, the practical effect of criminalizing every workrule breach is to give prosecutors almost total discretion in determining, after the fact, what conduct constitutes a crime and who should be criminally prosecuted.[46]

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41. According to the Journal, workrules restricting a reporter's trading of securities are the exception rather than the rule. *See Media Policies Vary on Preventing Employees and Others from Profiting on Knowledge of Future Business Stories*, Wall Street J., March 2, 1984 (A100).

42. 612 F. Supp. at 829, 35a. The Journal's conflicts of interest policy was first disclosed to its readers in a news article on March 2, 1984 — after the last securities trade alleged in the indictment (A47–49).

43. 612 F. Supp. at 831, 38a; *see United States v. Frade*, 709 F.2d 1387, 1392 (11th Cir. 1983) ("The finding that a defendant is aware that his conduct is generally unlawful is insufficient to sustain a finding of guilt under a statute requiring specific intent").

44. *See United States v. Ballard*, 663 F.2d 534, 543 (5th Cir. 1981) (reversing convictions of mail fraud, conspiracy and aiding and abetting when there was no evidence that defendants knew of the duty owed by codefendant–principal).

45. Neither Congress nor the New York State legislature has deemed the public interest to require protecting a newspaper's publication schedule through criminal penalties or even civil liabilities. The New York Penal Law, for example, limits the crime of unlawful use of private, confidential information to a narrowly defined category of "secret scientific material." N.Y. PENAL LAW § 165.07 (McKinney 1975 & Supp. 1986). *See also id.* § 155.00 [subd. 6].

46. *See* Jeffries, *Legality, Vagueness and the Construction of Penal Statutes*, 71 Va. L. Rev. 189, 190–201 (1985).

Nor is the power to criminalize private rules limited to breaches of employer workrules. The Court of Appeals' decision creates a federal felony wherever there may be said to be a "breach of fiduciary duty," a phrase that, as this Court has noted, "only begins an analysis" rather than provides guidance or certainty.[47] Yet, the decision below and its immediate precedents effectively "read the wire fraud statute to embody a federal law of fiduciary obligations, including an undefined duty of yet further disclosure, enforceable by the sanctions of criminal law."[48] No more should this be permitted under the language of the mail and wire fraud statutes than it is permitted under the (if anything) broader language of the securities fraud statutes. *See Chiarella*, 445 U.S. at 234–35.

Second, this decision extends the "deprivation of intangibles" approach to the mail fraud requirement that the defendant intend actual harm to his victim,[49] by holding that such harm can include harm to a newspaper's "reputation for professionalism." 791 F.2d at 1035, 24a. Quite aside from the total absence of any finding or evidence that petitioners intended such harm,[50] the simple truth is that if a concept as loose as "reputation for professionalism" can satisfy the harm requirement of the mail and wire fraud statutes, then the requirement has effectively been eliminated *sub silentio*.

The sole interest protected by this prosecution — *viz.*, a newspaper's reputation — is not the kind of interest that has

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47. *SEC v. Chenery Corp.*, 318 U.S. 80, 85–86 (1943) (Frankfurter, J.). *See also Bronston*, 658 F.2d at 931 (Van Graafeiland, J., dissenting). The difficulties faced by the district courts in discerning the new criminal reach of "fiduciary duty" are made forcefully apparent in *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985) (mail fraud indictment of son for alleged breach of fiduciary duty to father).

48. *Seigel*, 717 F.2d at 24 (Winter, J., dissenting).

49. *See, e.g., United States v. Regent Office Supply Co.*, 421 F.2d 1174 (2d Cir. 1970).

50. Instead of finding actual harm or intent to harm, the district court merely *presumed* harm from the fiduciary breach itself. 612 F. Supp. at 845–46, 64a.

historically been held to warrant the invocation of society's severest sanction, criminal penalties. Just as the dissent here notes that "[h]arm to reputation . . . never has been recognized as a proper subject for redress under section 10(b) or rule 10b–5," 791 F.2d at 1037, 29a, so too it has never before been recognized as a proper subject for redress under the mail or wire fraud statutes.[51] Such a qualitative extension of the scope of the criminal statutes should be left to the legislature.[52]

Third, the decision, in holding that the mailings and wirings in this case were adequate because they were "important" to the success of the scheme and were "reasonably foreseeable" by the defendants, 791 F.2d at 1035, 24–25a, studiously ignores not only the relevant precedents of this Court (such as *Maze*, *Parr*, and *Kann*, *supra* note 29), but also the statutory language itself, which requires that the defendants "cause" these mailings or interstate wirings for the "purpose" of executing their fraudulent scheme. Winans' job was to write accurate columns for the Journal, which, along with the rest of the text of the paper, were then conveyed by interstate wire communication (the predicate wirings) to the printing plant, from where the paper was distributed, partly by mail (the predicate mailings), to its subscribers. The alleged fraud did not change any of this one iota. Neither the timing nor the accuracy of the columns was affected; the wire transmission in form and content was exactly what it would have been in the absence of Winans' breach of the Journal's workrules. Nor were the mailings even directed to the only alleged victim of fraud, the Wall Street Journal; indeed, on the theory of this prosecution, the "fraud" — consisting of Winans' unauthorized use of the Journal's publication schedule — was

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51. In so stating, the dissent here, and we, discount the "sullying of reputation" language in *Newman*, 664 F.2d at 17, as pure dictum; but, in any event, *Newman* suffers from many of the same infirmities as the decision here. Indeed, one major reason for the over-expansion of the mail and wire fraud statutes is that it has occurred piecemeal with one panel building ever further on an earlier panel's decision, without stepping back to examine the overall effect of the progression.

52. *Dowling v. United States*, 105 S. Ct. 3127, 3132 (1985). *See also* Jeffries, *supra* note 46, at 202–05.

entirely completed before any relevant mailing or interstate wiring occurred.

To be sure, the defendants took advantage of the fact that Winans' columns would be printed and distributed to realize certain financial benefits from their arrangement. But to equate this with the statutory requirement that they "cause" the mailings and wirings "for the purpose" of executing their scheme is to deprive the statutory words of their ordinary meaning. In no linguistically recognized sense did the defendants "cause" these mailings and wirings, let alone cause them for the "purpose" of furthering their scheme.[53] As Judge Posner recently noted:

> The distinction between mailing a letter to execute a fraud and merely taking advantage of a criminal opportunity created by a letter sent for a lawful purpose is at the heart of *Parr v. United States*, 363 U.S. 370 (1960) ... .
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> • • •
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> Missing from both *Parr* and this case is a causal connection between the purpose and the mailings; the mailings would have occurred anyway. This point has been a ground of decision in other cases besides *Parr* — showing that *Parr* is not some legal sport that we are free to ignore because the other courts of appeals have ignored it. See *United States v. Curry*, 681 F.2d 406, 412 (5th Cir. 1982); *United States v. Boyd*, 606 F.2d 792, 794 (8th Cir. 1979) (alternative holding); cf.

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53. Almost every radio and television station in the country transmits interstate. Many, if not most, newspapers and magazines are mailed. Under the government's theory, if consistently applied, reporting of true, accurate and non-misleading information becomes a criminal fraud if assisted by a journalist or editor whose undisclosed self-interest (political, emotional, or economic) in the subject-matter of the report — though it does not affect the accuracy of his reporting — could be a source of embarrassment to his employer.

United States v. Brown, 540 F.2d 364, 377 (8th Cir. 1976).[54]

On every score, then, this decision marks the furthest extension to date of the recent "limitless" expansion of the mail and wire fraud statutes. As noted, previous steps in that expansion have been severely criticized in dissenting opinions in the Second Circuit,[55] and in dissenting, concurring, and even majority opinions in other Circuits.[56] The near–unanimous weight of

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54. *Green*, 786 F.2d at 256–58 (Posner, J., dissenting). The majority in *Green* similarly believed that *Parr* "may require proof that [the predicate] mailings were used with specific intent to defraud the recipients of the mail," but found that such proof had been adduced in *Green*. No such proof was adduced here, however, nor could it be. Thus, the Second Circuit's position is seemingly at odds with that of the Seventh (and other) Circuits. *See also United States v. Castile*, 795 F.2d 1273 (6th Cir. 1986); *United States v. Tarnopol*, 561 F.2d 466 (3d Cir. 1977).

55. *See, e.g., Weiss*, 752 F.2d at 791–95 (Newman, J., dissenting); *Siegel*, 717 F.2d at 23–24 (Winter, J., dissenting); *Margiotta*, 688 F.2d at 139–44 (Winter, J., dissenting); *Bronston*, 658 F.2d at 930–33 (Van Graafeiland, J., dissenting). *See also Pisani*, 773 F.2d at 410 (Pratt, J.) (reversing mail fraud conviction based on fiduciary breach); *United States v. Dixon*, 536 F.2d 1388, 1398–1401 (2d Cir. 1976) (Friendly, J.) (reversing mail fraud conviction held to be "a considerable distance from the ordinary meaning of 'scheme or artifice to defraud'"). Many of the Second Circuit decisions extending the mail and wire fraud statutes reversed decisions by thoughtful district judges, who, even within the confines of prior Second Circuit precedents, did not believe that the statutes could be further stretched. *See, e.g., Newman*, 664 F.2d 12 (reversing dismissal of indictment by Haight, J.); *Von Barta*, 635 F.2d 999 (reversing dismissal of indictment by Brieant, J.).

56. *E.g., United States v. Hewes*, 729 F.2d 1302, 1322 (11th Cir. 1984), *cert. denied sub nom. Caldwell v. United States*, 105 S. Ct. 790 (1985); *United States v. Lemire*, 720 F.2d 1327, 1335–36 (D.C. Cir. 1983) (majority opinion expressing "second thoughts" about expansion of mail fraud, and rejecting government's theory that "would criminalize any intentional undisclosed breach of duty to an employer"), *cert. denied*, 467 U.S. 1226 (1984); *Curry*, 681 F.2d at 418–25 (Garwood, J., concurring) (expressing disagreement with "intangible rights" theory of mail fraud); *United States v. Rabbitt*, 583 F.2d 1014 (8th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979); *United States v. Craig*, 573 F.2d 455, 497–505 (7th Cir. 1977) (Swygert, J., dissenting) (describing the extension of the mail and wire fraud statutes as a

scholarly opinion has condemned the trend.[57] It is high time for this Court to review it, and reverse it.

"pernicious trend"), *cert. denied*, 439 U.S. 820 (1978); *Caldwell*, 544 F.2d at 697–98 (Widener, J., concurring) (suggesting limitation of mail fraud prosecutions to defrauding of tangibles); *United States v. McNeive*, 536 F.2d 1245 (8th Cir. 1976); *United States v. Edwards*, 458 F.2d 875, 880 (5th Cir.), *cert. denied sub nom. Huie v. United States*, 409 U.S. 891 (1970); *United States v. Kelem*, 416 F.2d 346, 347 (9th Cir. 1969), *cert. denied*, 397 U.S. 952 (1970).

57. *See, e.g.*, Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117 (1981) (criticizing the entire development, especially as applied in *Bronston*); Jeffries, *supra* note 46 (criticizing as "case–by–case criminalization" the extension of the mail fraud statute to fiduciary breaches as applied in *Margiotta*); Tigar, *Mail Fraud, Morals, and U.S. Attorneys*, 11 LITIGATION 22 (Fall 1984); Note, *Intra–Corporate Mail and Wire Fraud: Criminal Liability for Fiduciary Breach*, 94 Yale L.J. 1427 (1985) (criticizing the mail fraud fiduciary breach standard as "untenable" as applied in *Siegel* and *Weiss*). *See also* Coffee, *The Metastasis of Mail Fraud: The Continuing Story of the "Evolution" of a White–Collar Crime*, 21 Am. Crim. L. Rev. 1 (1983); Hurson, *Limiting the Federal Mail Fraud Statute—A Legislative Approach*, 20 Am. Crim. L. Rev. 423 (1983); Comment, *supra* note 27, at 578.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray that the Court issue writ of certiorari to review the judgments of the Court of Appeals for the Second Circuit.

Dated: September 15, 1986

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 546, 524, 525—August Term, 1985

(Argued: November 26, 1985 Decided: May 27, 1986)

Docket Nos. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

—v.—

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

Defendants-Appellants.

Before:

MANSFIELD, PIERCE and MINER,

Circuit Judges.

Appeal from judgments of conviction entered after a non-jury trial in the United States District Court for the Southern District of New York, Stewart, *Judge*, for securities fraud, mail and wire fraud, aiding and abetting,

and conspiracy to misappropriate material, nonpublic information from the *Wall Street Journal* in connection with the purchase and sale of securities.

Affirmed in part and reversed in part.

Miner, Circuit Judge, dissents in part in a separate opinion.

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—and—

Daniel L. Goelzer, Esq., Jacob H. Stillman, Esq., Rosalind C. Cohen, Esq., Richard A. Levine, Esq. (Paul Gonson, Esq., of counsel), on the brief for the Securities and Exchange Commission, Washington, D.C., *as Amicus Curiae*.

Benjamin W. Heineman, Jr., Esq., Carter G. Phillips, Esq., and Mark D. Hopson, Esq. (Sidley & Austin, Washington, D.C., of counsel), on the brief for the Reporters' Committee for Freedom of the Press, the National Association of Broadcasters, the New York Financial Writers Association, the Media Institute, the Newspaper Guild, the Radio-Television News Directors Association, the American Society of Magazine Editors, the National Newspaper Association, and the Associated Press Managing Editors, *as Amici Curiae in support of Defendants-Appellants*.

PIERCE, *Circuit Judge*:

This is an appeal from judgments of conviction in the United States District Court for the Southern District of New York, Charles E. Stewart, Jr., *Judge*, entered after a twenty-day non-jury trial, following which Winans and Felis were found guilty of securities fraud by misappropriating material, nonpublic information from the *Wall*

Street Journal ("*Journal*") in connection with the purchase and sale of securities, and of mail and wire fraud. Winans and Felis were also convicted of conspiracy to commit such securities and mail and wire frauds and to obstruct justice. Carpenter was convicted of aiding and abetting in the commission of securities fraud and mail and wire fraud. *United States v. Winans, et al.*, 612 F. Supp. 827 (S.D.N.Y. 1985).

Appellants contend, *inter alia*, that they may not be held criminally liable for violating, or conspiring to violate or aiding and abetting in violating, section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78ff, and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, because they were not corporate insiders or "quasi-insiders" and did not misappropriate material nonpublic information from such insiders or "quasi-insiders."

We hold that section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 proscribe an employee's unlawful misappropriation from his employer, a financial newspaper, of material nonpublic information in the form of the newspaper's forthcoming publication schedule, in connection with a scheme to purchase and sell securities to be analyzed or otherwise discussed in future columns in that newspaper, and that the use of the newspaper's interstate wire and mail production and distribution channels for purposes of effectuating said scheme may serve as a predicate for criminal liability for mail and wire fraud. We therefore affirm the convictions based on these substantive counts. We also affirm the district court's conviction of defendants Winans and Felis of conspiracy and of defendant Carpenter of aiding and abetting. However, we reverse Winans' conviction of conspiracy to the extent

that it is based upon certain trades made between Felis and a third party, named Stephen Spratt, since these transactions were not within the scope of the unlawful agreement to trade on the misappropriated information.

Affirmed in part and reversed in part.

BACKGROUND

Defendants Kenneth P. Felis ("Felis"), and R. Foster Winans ("Winans") appeal from judgments of conviction for federal securities fraud in violation of section 10(b) of the 1934 Act and Rule 10b-5; mail fraud in violation of 18 U.S.C. § 1341; and wire fraud in violation of 18 U.S.C. § 1343, all in connection with certain securities trades conducted on the basis of material, nonpublic information regarding the subject securities contained in certain articles to be published in the *Wall Street Journal*. Winans and Felis also appeal from judgments of conviction for conspiracy to commit securities fraud and mail and wire fraud and to obstruct justice, in violation of 18 U.S.C. § 371, and David Carpenter ("Carpenter") appeals from a judgment of conviction for aiding and abetting.

Since March 1981, Winans was a *Wall Street Journal* reporter and one of the writers of the "Heard on the Street" column (the "Heard" column), a widely read and influential column in the *Journal*. Carpenter worked as a news clerk at the *Journal* from December 1981 through May 1983. Felis, who was a stockbroker at the brokerage house of Kidder Peabody, had been brought to that firm by another Kidder Peabody stockbroker, Peter Brant ("Brant"), Felis' longtime friend who later became the government's key witness in this case.

Since February 2, 1981, it was the practice of Dow Jones, the parent company of the *Wall Street Journal*, to distribute to all new employees "The Insider Story," a forty-page manual with seven pages devoted to the company's conflicts of interest policy. The district judge found that both Winans and Carpenter knew that company policy deemed all news material gleaned by an employee during the course of employment to be company property and that company policy required employees to treat nonpublic information learned on the job as confidential.[1]

Notwithstanding company policy, Winans participated in a scheme with Brant and later Felis and Carpenter in which Winans agreed to provide the two stockbrokers (Brant and Felis) with securities-related information that was scheduled to appear in "Heard" columns; based on this advance information the two brokers would buy or sell the subject securities. Carpenter, who was involved in a private, personal, non-business relationship with Winans, served primarily as a messenger between the conspirators. Trading accounts were established in the names of Felis, Carpenter, Winans, Brant, David Clark, Western Hemisphere, and Stephen Spratt.[2] During 1983 and early 1984, defendants made prepublication trades on the basis of their advance knowledge of approximately

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1 The district court found that whether confidentiality constituted a company "policy" or "practice" is a distinction without merit. Rather, it found significant that Winans had actual knowledge of the policy and that Carpenter was aware generally of the policy. 612 F. Supp. at 831.

2 David Clark refers to one of Brant's clients. Stephen Spratt refers to a friend of Felis. Western Hemisphere was the name on a Swiss bank account that Felis and Winans used after Kidder Peabody's Compliance Department became suspicious that Felis had pre-publication knowledge regarding certain "Heard" columns.

twenty-seven *Wall Street Journal* "Heard" columns, although not all of those columns were written by Winans. Generally, Winans would inform Brant of the subject of an article the day before its scheduled publication. Winans usually made his calls to Brant from a pay phone, and often used a fictitious name. The net profits from the scheme approached $690,000. The district court found that this scheme did not affect the subject matter or quality of Winans's columns, since "[m]aintaining the journalistic purity of the column was actually consistent with the goals of the conspirators," given that the predictability of the columns' market impact depended in large part on the perceived quality and integrity of the columns. 612 F. Supp. at 835 n.4.

In November 1983, when Kidder Peabody's Compliance Department noticed a correlation between "Heard" articles and trading in the Felis and Clark accoun[illegible] Felis was questioned by a Kidder Peabody supervisor. Felis denied any impropriety. However, he and Brant moved certain funds among accounts to conceal the continued operation of the scheme. Indeed, Felis had previously advised his friend, Stephen Spratt, to whom he had provided advance information on four occasions, to change the names on certain accounts so as to avoid being discovered. When the SEC began inquiring into the scheme, Clark and Brant both made misstatements to agency officials, and Carpenter produced false invoices that apparently had been designed to conceal the truth from the SEC. Later, on March 29, 1984, Winans and Carpenter voluntarily testified fully at the SEC about this and about the scheme.

DISCUSSION

The fairness and integrity of conduct within the securities markets is a concern of utmost significance for the proper functioning of our securities laws. In broadly proscribing "deceptive" practices in connection with the purchase or sale of securities pursuant to section 10(b) of the Securities Exchange Act of 1934, Congress left to the courts the difficult task of interpreting legislatively defined but broadly stated principles insofar as they apply in particular cases. This case requires us to decide principally whether a newspaper reporter, a former newspaper clerk, and a stockbroker, acting in concert, criminally violated or conspired to violate or aided and abetted in the violation of federal securities laws by misappropriating material, nonpublic information in the form of the timing and content of the *Wall Street Journal's* confidential schedule of columns of acknowledged influence in the securities market, in contravention of the established policy of the newspaper, for their own profit in connection with the purchase and sale of securities.

I.

Although the facts render the securities fraud issue herein one of first impression, we do not write on a clean slate in assessing whether this case falls within the purview of the "misappropriation" theory of section 10(b) and Rule 10b–5 thereunder.[3] In 1980, the Supreme Court

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[3] Section 10(b), 15 U.S.C. § 78j(b), prohibits the use "in connection with the purchase or sale of any security. . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. . . ."

Rule 10b–5, 17 C.F.R. § 240.10b–5, states:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

left open the question of the viability of that theory, *Chiarella v. United States*, 445 U.S. 222 (1980), with the concurring and dissenting opinions suggesting that had the theory been presented to the jury, Chiarella's conviction might have been affirmed.[4] Since then, the theory

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(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

4 In Chief Justice Burger's view, the employee's conviction should have been affirmed because "the evidence shows beyond all doubt that Chiarella, working literally in the shadows of the warning signs [stating employer's confidentiality policy] in the printshop misappropriated—stole, to put it bluntly—nonpublic information entrusted to him in the utmost confidence." *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting). Justice Brennan, while disagreeing with the Chief Justice's view of the evidence, agreed that "a person violates § 10(b) whenever he improperly obtains or converts to his own benefit nonpublic information which he then uses in connection with the purchase or sale of securities." *Id.* at 239 (Brennan, J., concurring). Justice Blackmun, with whom Justice Marshall joined, wrote more broadly that even without resting Chiarella's conviction on a "misappropriation" theory, it was enough that the employee "purloined," *id.* at 246 (Blackmun, J., dissenting), information to which he had unique access by virtue of his position and the trust that attached to that position, *id.* at 246-52 (Blackmun, J., dissenting). Justice Stevens, while concurring in the opinion of the Court, wrote separately "to emphasize the fact that we have not necessarily placed any stamp of approval on what this petitioner did, nor have we held that similar actions must be considered lawful in the future." *Id.* at 238 (Stevens, J., concurring). Further, wrote Justice Stevens, the Court manifestly left open the question of whether the conviction could have been affirmed on grounds of misappropriation since that theory had not been presented to the jury.

We also note that the Court recently reiterated that tippee liability under section 10(b) may arise not only from participation in an insider's breach of fiduciary duty, but also where a tippee "otherwise 'misappropriate[s] or illegally obtains[s] the information.' " *Eichler v. Berner*, 105 S. Ct. 2622, 2630 & n.22 (1985) (quoting *Dirks v. SEC*, 463 U.S. 646, 665 (1983); citing H. Rep. No. 98-355 at 14-15 (1983), *reprinted in* [1984] U.S. Code Cong. & Ad. News 2274).

has been applied twice by this court. *See SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). It is clear that defendant Winans, as an employee of the *Wall Street Journal*, breached a duty of confidentiality to his employer by misappropriating from the *Journal* confidential prepublication information, regarding the timing and content of certain newspaper columns, about which he learned in the course of his employment.[5] We are presented with the question of whether that unlawful conduct may serve as the predicate for the securities fraud charges herein.

The core of appellants' argument is that *Newman* and *Materia* are inapposite because in those cases the information was misappropriated by employees who owed a duty of confidentiality not only to their employers, but also to their employers' clients, the corporations whose securities were traded. In other words, appellants argue, the misappropriation theory may be applied only where the information is misappropriated by corporate insiders or so-called quasi-insiders, *Dirks v. SEC*, 463 U.S 646, 655 n.14 (1983), who owe to the corporation and its shareholders a fiduciary duty of abstention or disclosure.

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5 *See, e.g.*, Rest. Agency 2d § 395, which provides:

> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge.

The general tort of breach of a duty of confidentiality to an employer is, of course, well-settled. *See, e.g., Franke v. Wiltschek*, 209 F.2d 493, 495 (2d Cir. 1953) (citing authority).

Thus, appellants would have us hold that it was not enough that Winans breached a duty of confidentiality to his employer, the *Wall Street Journal*, in misappropriating and trading on material nonpublic information; he would have to have breached a duty to the corporations or shareholders thereof whose stock they purchased or sold on the basis of that information.

Appellants read *Newman* and *Materia* and interpret the misappropriation theory too narrowly. Notwithstanding the existence of corporate clients of the employers in *Newman* and *Materia*, the misappropriation theory more broadly proscribes the conversion by "insiders" *or others* of material non-public information in connection with the purchase or sale of securities. *See Materia*, 745 F.2d at 203 (liability may arise merely because one "misappropriates non-public information in breach of a fiduciary duty and trades on that information to his advantage"); *id.* at 201 (section 10(b) was not "aimed solely at the eradication of fraudulent trading by corporate insiders"); *cf. Newman*, 664 F.2d at 17 ("the language of Rule 10b-5 . . . contains no specific requirement that fraud be perpetrated upon the seller or buyer of securities"); *SEC v. Musella*, 578 F. Supp. 425, 438 (S.D.N.Y. 1984) (*Newman* "gave legal effect to the commonsensical view that trading on the basis of improperly obtained information is fundamentally unfair, and that distinctions premised on the source of the information undermine the prophylactic intent of the securities laws"). It is precisely such conversion that serves as the predicate for the convictions herein.

Although *Dirks* disapproved of certain trading by insiders or quasi-insiders who owe a fiduciary duty to investors, courts are not thereby constrained from recog-

nizing other misconduct. To give *Dirks* such preclusive effect would suggest that one application of a statute cannot admit of another application not raised in the first case. As the district court correctly stated, "[i]t is not accurate to say that *Dirks* wrote the book on insider or outsider trading; it wrote one chapter with respect to one type of fraudulent trading." 612 F. Supp. at 842. Indeed, the chapter that *Dirks* wrote derives from prior jurisprudence in which "fine distinctions and rigid classifications" were appropriately foresaken to facilitate the recognition of significant doctrinal reasons for holding members of particular, even if new, groups liable. *See In Re Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961) (liability not restricted to "traditional" insiders such as officers, directors and controlling stockholders), *cited approvingly in Dirks*, 463 U.S. at 653. Given the broad remedial purposes of the securities laws, the Supreme Court has "repeatedly recognized that securities laws combatting fraud should be construed 'not technically and restrictively but flexibly,' " *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963)). Other cases involving the misappropriation theory have distinguished *Dirks* substantially for the reasons stated in the district court opinion. *SEC v. Materia*, [1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 99,526, 99,543 (S.D.N.Y. 1983), *aff'd*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 105 S. Ct. 2112 (1985); *SEC v. Musella*, 578 F. Supp. at 437-43; *United States v. Reed*, 601 F. Supp. 685, 699-703 (S.D.N.Y. 1985), *rev'd in part*, 773 F.2d 477 (2d Cir. 1985) (reinstating perjury and obstruction counts).

Further, we think that the application of the misappropriation theory herein promotes the purposes and policies

underlying section 10(b) and Rule 10b-5. In construing the Rule's meaning, we must begin with its language. *Chiarella*, 445 U.S. at 226; *Santa Fe Industries v. Green*, 430 U.S. 462, 472 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). The Rule prohibits "*any* person," acting "directly or indirectly," from employing "*any* device, scheme or artifice to defraud." It equally prohibits "*any* act, practice, or course of business which operates as a fraud or deceit upon *any* person." 17 C.F.R. § 240.10b-5 (emphasis added). This repeated use of the word "any" evidences Congress' intention to draft the Rule broadly. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972). The Supreme Court has recognized that section 10(b) of the 1934 Act, as implemented by Rule 10b-5, "was designed as a catchall clause to prevent fraudulent practices." *Chiarella*, 445 U.S. at 226 (citing *Ernst & Ernst*, 425 U.S. at 202, 206).

The legislative intent of the 1934 Act is similarly broad-reaching. As this Court has noted in applying the misappropriation theory, "the antifraud provision was intended to be broad in scope, encompassing all 'manipulative and deceptive practices which have been demonstrated to fulfill no useful function.' " *Materia*, 745 F.2d at 201 (quoting S. Rep. No. 792, 73d Cong., 2d Sess., 6 (1934)). We perceive nothing "useful" about defendants' scheme. Nor, in our view, could any purported function of the scheme[6] be considered protected given Congress' stated concern for the perception of fairness and integrity

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6 *See, e.g.*, Farley, *A Current Look at the Law of Insider Trading*, 39 Bus. Law. 1771, 1782 (1984) (defending "misappropriation" as facilitating the transfer of information vital to market efficiency); *cf.* Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of* Dirks v. Securities and Exchange Commission, 8 Hofstra L. Rev. 127, 133 (1984) (defending *Dirks* on same grounds).

in the securities markets and the potential costs of foresaking such legislated concerns, including fewer market participants and greater reliance on fraud as a means of competing in the market. *See, e.g.*, H.R. 9323, 73d Cong., 2d Sess., Rept. No. 1383 at 7865-66, *reprinted in* 1 Federal Bar Association Securities Law Committee, *Federal Securities Laws* 856-57 (1983) ("a wise and judicious administration of the provisions of this [A]ct will create a new confidence in the integrity of the securit[ies] markets"); Twentieth Century Survey and Study, *cited in* H.R. 9323, *supra*, at 7866, *reprinted in* Federal Securities Laws, *supra*, at 857 (seeking to create "a justifiable belief that securit[ies] markets actually were 'free and open' ").

In construing Congressional intent, we also find persuasive Congress' recent statements accompanying the Insider Trading Sanctions Act of 1984, P.L. No. 98-376, 98 Stat. 1264 (1984), relating to the purposes and scope of the 1934 Act and its antifraud provisions. *See Eichler v. Berner*, 105 S. Ct. 2622, 2630 n.23, 2633 n.32 (1985) (construing section 10(b) in light of the provisions and legislative history of the Insider Trading Sanctions Act of 1984); *see also Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 380-81 (1969) (subsequent legislative history "entitled to great weight in [prior] statutory construction"); *Consolidated Edison Co. v. United States*, 782 F.2d 322, 324 n.3 (2d Cir. 1986) (per curiam) (noting persuasiveness of subsequent legislative history as to meaning of prior law). The use of subsequent legislative history is especially appropriate where, as here, the original history is limited. *See Santa Fe Industries v. Green*, 430 U.S. 462, 473 n.13 (1977) (noting paucity of legislative history on section 10(b)); *Ernst & Ernst*, 425 U.S. at 202 (same). In enacting the Insider Trading Sanctions Act

of 1984, Congress noted that the intent of the 1934 Act was to condemn all manipulative or deceptive trading "whether the information about a corporation or its securities originates from inside or outside the corporation." H.R. Rep. No. 98-355, 98th Cong., 1st Sess. 3, 4 (1983), *reprinted in* [1984] U.S. Code Cong. & Ad. News 2274. Further, the reason for this view was clearly stated: "the abuses sought to be remedied [by section 10(b)] were not limited to actions of corporate insiders and large shareholders." *Id.* Clearly, Congress has understood its predecessors to have delineated illegal conduct along the lines not simply of relationships to corporations and duties arising thereunder, as developed by the line of cases through *Cady, Roberts* and *Dirks*. Rather, Congress apparently has sought to proscribe as well trading on material, nonpublic information obtained not through skill but through a variety of "deceptive" practices, unlawful acts which we term "misappropriation." *See* Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 106 & n.33 (1984).[7]

We do not say that merely using information not available or accessible to others gives rise to a violation of Rule 10b-5. That theory of 10b-5 liability has been rejected. *See Chiarella*, 445 U.S. at 235 (rejecting "parity of information" theory); *id.* at 235 n.20 (rejecting "access to information" theory). There are disparities in knowl-

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[7] *See also* ABA Committee on Federal Regulation of Securities, Report of the Task Force on Regulation of Insider Trading—Part I: Regulation under the Antifraud Provisions of the Securities Exchange Act of 1934, 41 Bus. Law. 223, 235-37, 253-63, 270-71 (1985) (reviewing misappropriation cases and proposing express codification of misappropriation theory without limitation to insiders, quasi-insiders or their tippees).

edge and the availability thereof at many levels of market functioning that the law does not presume to address. However, the critical issue is found in the district judge's careful distinction between "information" and "conduct." 612 F. Supp. at 842. Whatever may be the legal significance of merely using one's privileged or unique position to obtain material, nonpublic information, here we address specifically whether an employee's use of such information in breach of a duty of confidentiality to an employer serves as an adequate predicate for a securities violation. Obviously, one may gain a competitive advantage in the marketplace through conduct constituting skill, foresight, industry and the like. Certainly this is as true in securities law as in antitrust, patent, trademark, copyright and other fields. But one may not gain such advantage by conduct constituting secreting, stealing, purloining or otherwise misappropriating material nonpublic information in breach of an employer-imposed fiduciary duty of confidentiality. Such conduct constitutes chicanery, not competition; foul play, not fair play. Indeed, underlying section 10(b) and the major securities laws generally is the fundamental promotion of " 'the highest ethical standards . . .' in every facet of the securities industry." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186-187 (1963) (quoting *Silver v. New York Stock Exchange*, 373 U.S. 341, 366 (1963)), *cited approvingly in Eichler*, 105 S. Ct. at 2631. We think the broad language and important objectives of section 10(b) and Rule 10b-5 render appellants' conduct herein unlawful, as in *Newman* and *Materia*. *See also*, *In re Investors Management Co.*, 44 S.E.C. 633, 641 n.18 (1971) (SEC stating that Rule 10b-5 extends to trading based upon

"information . . . obtained by industrial espionage, commercial bribery or the like").

We do not think that the "fraud and deceit" in this case significantly differ from the "fraud and deceit" in *Newman* and *Materia*. Winans "misappropriated—stole, to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence." *Chiarella*, 445 U.S. at 245 (Burger, C.J., dissenting), *quoted in Materia*, 745 F.2d at 201. The information misappropriated here was the *Journal's* own confidential schedule of forthcoming publications. It was the advance knowledge of the timing and content of these publications, upon which appellants, acting secretively, reasonably expected to and did realize profits in securities transactions.[8] Since section 10(b) has been found to proscribe fraudulent trading by insiders or outsiders, such conduct constituted fraud and deceit, as it would had Winans stolen material nonpublic information from traditional corporate insiders or quasi-

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[8] We cannot agree with the conclusion drawn from the view expressed by our brother, Judge Miner, in his dissenting opinion, that the prepublication schedules were not "secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published." In our view, that statement exalts the exception over the rule. The district court found that between October 1983 and the end of February 1984, twenty-seven "Heard" columns were leaked in advance. 623 F. Supp. at 833. If an occasional investment plan faltered due to nonpublication of the anticipated corollary "Heard" column, the record nonetheless amply demonstrates that the majority of the securities traded resulted in profits reflecting the predictable price change due to the publication anticipated. This was true, for example, of trades in American Surgery Centers, Institutional Investors, and TIE/Communications, Inc., to mention just a few of the securities traded. In any event, a fraudulent scheme need not be foolproof to constitute a violation of Rule 10b-5. It is enough that appellants reasonably expected to and generally did reap profits by trading on the basis of material, nonpublic information misappropriated from the *Journal* by an employee who owed a duty of confidentiality to the *Journal*.

insiders. *See Materia*, 745 F.2d at 201-03. Felis' liability as a tippee derives from Winans' liability given the district court's finding of the requisite scienter on Felis' part. *See Ernst & Ernst*, 425 U.S. 185.

Nor is there any doubt that this "fraud and deceit" was perpetrated "upon a[ny] person" under section 10(b) and Rule 10b-5. It is sufficient that the fraud was committed upon Winans' employer. *See Materia*, 745 F.2d at 202 (printing press employee liable for fraud upon employer); *Newman*, 664 F.2d at 17 (investment banking employees liable principally for "sullying the reputations" of their employers); *Musella*, 578 F. Supp. at 438 (office manager liable for sullying reputation of law firm). Appellants Winans, and Felis and Carpenter by their complicity, perpetrated their fraud "upon" the *Wall Street Journal*, sullying its reputation and thereby defrauding it "as surely as if they took [its] money." *Newman*, 664 F.2d at 17.

As to the "in connection with" standard, the use of the misappropriated information for the financial benefit of the defendants and to the financial detriment of those investors with whom appellants traded supports the conclusion that appellants' fraud was "in connection with" the purchase or sale of securities under section 10(b) and Rule 10b-5. We can deduce reasonably that those who purchased or sold securities without the misappropriated information would not have purchased or sold, at least at the transaction prices, had they had the benefit of that information. *See, e.g., Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974). Certainly the protection of investors is the major purpose of section 10(b) and Rule 10b-5. *Id.* at 235. Further,

investors are endangered equally by fraud by non-inside misappropriators as by fraud by insiders.[9]

Appellants correctly point out that "not every instance of financial unfairness constitutes fraudulent activity under Section 10(b)," *Chiarella*, 445 U.S. at 232; that the "misappropriation theory" requires a nexus between the duty and the federal securities regulatory scheme, *id.* at 222; *Newman*, 664 F.2d at 12; *Materia*, 745 F.2d at 197. Here, however, the misappropriated information regarding the timing and content of certain *Journal* columns had "no value whatsoever [to appellants] except 'in connection with' [their] subsequent purchase[s] [and sales] of securities." *Materia*, 745 F.2d at 203. The "sole purpose" of the scheme was to purchase and sell securities, *see*

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9 We disagree with the view expressed by Judge Miner in his dissenting opinion that no "securities-related" information was purloined. For purposes of Rule 10b-5, an omission (or a misstatement) may be considered "material" if the information omitted (or misstated) "in reasonable and objective contemplation might affect the value of the corporation stock or securities . . . ." *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 849 (2d Cir. 1968) (Waterman, J.) (quoting *Kohler v. Kohler Co.*, 319 F.2d 634, 642 (7th Cir. 1963)), *cert. denied*, 394 U.S. 976 (1969). *See also Radiation Dynamics v. Goldmuntz*, 464 F.2d 876, 888 (2d Cir. 1972) (approving materiality instruction substantially following language in *Texas Gulf Sulphur*); *cf. TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (holding omission material "if there is a substantial likelihood that a reasonable shareholder would consider it important"). In our view, the satisfaction of this standard, even narrowly defined, is beyond question, given that the "Heard" columns had undisputed significant market impact; that after the first attempt at profits Winans and Felis recognized that profits woud be reaped if trades were made on the basis of analyses of *particular* securities (rather than of general industries) to be published in forthcoming columns, *see* 612 F. Supp. at 833; that generally, "transactions were closed on the same day as an article's publication, thereby maximizing its impact," *id.* at 834; and that, once the mature scheme was in operation, net profits therefrom approached $690,000 over several months. *Id.* Indeed, the prices of the twenty-nine stocks traded often changed significantly, sometimes even dramatically, between the closing prices the day before publications and the opening prices at 10:00 a.m. on the day of publications.

Newman, 664 F.2d at 18; *see also Jannes v. Microwave Communications, Inc.*, 461 F.2d 525, 528-30 (7th Cir. 1972), and thereby virtually to "reap instant no-risk profits in the stock market." *Materia*, 745 F.2d at 203. Indeed, given the breadth of the "in connection with" standard, *see, e.g., Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 815 (2d Cir. 1975), appellants' argument to the contrary seems frivolous.

Appellants argue that it is anomalous to hold an employee liable for acts that his employer could lawfully commit. Admittedly, the employers in *Newman* were investment banks that would be barred by federal securities laws from trading in securities of their clients, while in the present case the *Wall Street Journal* or its parent, Dow Jones Company, might perhaps lawfully disregard its own confidentiality policy by trading in the stock of companies to be discussed in forthcoming articles.[10] But a reputable newspaper, even if it could lawfully do so, would be unlikely to undermine its own valued asset, its reputation, which it surely would do by trading on the basis of its knowledge of forthcoming publications. *See* Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 Hofstra L. Rev. 9, 43 (1984). Although the employer may perhaps lawfully destroy its own reputation, its employees should be and are barred from destroying their employer's reputation by

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10 We express no view as to whether trading by a newspaper on the basis of material, nonpublic prepublication information would constitute a securities violation as, *e.g.*, a "manipulative device" under section 10(b); or as unlawful touting under section 17 of the Securities Act of 1933, 15 U.S.C. § 77q (1933), *see* 3 L. Loss, Securities Regulation 1518-19 (1961); or under any other theory.

misappropriating their employer's informational property. Appellants' argument that this distinction would be unfair to employees illogically casts the thief and the victim in the same shoes.[11] A more apt analogy might be drawn between the employee-employer distinction herein and the fiduciary-corporate client distinction in *Newman*, *Materia*, and *Musella*. In these cases, the misappropriation theory prohibited, respectively, an investment bank, a financial printer, or a law firm, from trading on the material, nonpublic information of its corporate client, which itself presumably remained free to trade in its own securities, absent other contrary rules in the securities laws, such as the Williams Act five percent rule, 15 U.S.C. §§ 78m(d), 78n(d). Here, appellants, constrained by the employer's confidentiality policy, could not lawfully trade by fraudulently violating that policy, even if the *Journal*, the employer imposing the policy, might not be said to defraud itself should it make its own trades.

Thus, because of his duty of confidentiality to the *Journal*, defendant Winans—and Felis and Carpenter, who knowingly participated with him—had a corollary duty, which they breached, under section 10(b) and Rule 10b-5, to abstain from trading in securities on the basis of

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11 Indeed, theft or embezzlement of certain information is a statutory crime in some states. *See, e.g.*, N.Y. Pen. L. § 165.07 (McKinney's 1975) (unlawful use of secret scientific information); Mass. Gen. Laws, Chap. 266, § 30(4) (1985 Supp.) (theft of secret scientific material). Further, the victim of such theft or embezzlement may have a common law action for conversion against the misappropriator. See note 5, *supra*. Indeed, an employee's conversion may serve as the predicate for a securities violation. *Cf. Diamond v. Oreamuno*, 24 N.Y.2d 494, 503, 301 N.Y.S.2d 78, 85 (1969) (Fuld, Ch. J.) (permitting action alleging violation of section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), and section 10(b) if such action is brought by individual purchaser, in pertinent part based on directors' alleged breach of duty of confidentiality to corporation).

the misappropriated information or to do so only upon making adequate disclosure to those with whom they traded.

The district court properly found that defendants had adequate notice of the illegality of their scheme. *See Newman*, 664 F.2d at 19 (citing *United States v. Persky*, 520 F.2d 283, 288 (2d Cir. 1975)). Certainly appellants herein had fair notice from *Chiarella*, *Newman*, and the decision of the district court in *Materia* that their conduct might violate section 10(b). Although appellants argue that the misappropriation in their case, predicated on breach of a duty to the *Wall Street Journal* rather than to a quasi-insider corporate client, such as a printing company or an investment bank or a law firm, renders the previous cases distinguishable, they clearly treaded closely enough along proscribed lines for the district court to find that they had adequate notice of the illegality of their acts. *See United States v. Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir.), *cert. denied*, 462 U.S. 1131 (1983); *United States v. Bohonus*, 628 F.2d 1167, 1174 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980).

Finally, we do not agree with the position taken in the brief of *amici curiae* that the district court's decision portends First Amendment infringements. The confidentiality restrictions stem from the *Wall Street Journal* and Dow Jones company rules, not from any action by the government. Moreover, we cannot see how the convictions will chill free speech. If Winans had respected his employer's reasonable confidentiality policy, he would have had nothing to fear by publishing his "Heard" columns. Indeed, where a columnist uses his position to profit in transactions, at least one court has held that he may be compelled to disclose to his readers his potential

financial stake in the impact of his columns. *See Zweig v. The Hearst Corp.*, 521 F.2d 1129 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975).[12] The First Amendment generally empowers a journalist with no "special privilege" merely for the exercise of his craft, *see* Cox, *Foreword: Freedom of Expression in the Burger Court*, 94 Harv. L. Rev. 1, 51, 50-55 (1980), and the securities laws require of him, no less than of others, compliance therewith in the pursuit of his financial interests. In short, having failed to sustain their burden of persuasion that application of the securities laws infringed First Amendment rights, *see id.* at 52-53, either directly or through *amici*, appellants remain subject to section 10(b) as a rule of general applicability. *Cf. Zurcher v. Stanford Daily*, 436 U.S. 547, 566 (1978) (production of evidence in criminal investigation); *Branzburg v. Hayes*, 408 U.S. 665, 680 (1972) (same); *Associated Press v. United States*, 326 U.S. 1, 20 (1945) (antitrust laws).

II.

We need not dwell at length on appellants' convictions for violating federal mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. *See* 612 F. Supp. at 843-47. It is clear that "confidential and nonpublic commercial information" may constitute fraudulently misappropriated "property" under the mail fraud statute. *See United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Von Barta*,

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12 *But cf. Chiarella*, 445 U.S. at 231-35 (also a non-misappropriation case; subsequently holding no duty of disclosure to persons with whom defendant had no prior dealings and no agency or fiduciary relationship). Whether or not a columnist has a duty of disclosure to his readers under federal securities laws, we note that the court in *Zweig* held that he does without reference to the First Amendment.

635 F.2d 999, 1006 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981). Although not every breach of an employee's fiduciary duty to his employer constitutes mail or wire fraud, *id.* at 1002; *Newman*, 664 F.2d at 19, it is clear from *Von Barta* and *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982), that "the concealment by a fiduciary of material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to another is a violation of the [mail fraud] statute." *Newman*, 664 F.2d at 19 (quoting *Bronston*, 658 F.2d at 926). *See also United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983). In the present case, the scheme to misappropriate material nonpublic information regarding the *Journal's* forthcoming publications in breach of the employee's duty of confidentiality to the *Journal* in connection with securities transactions met the requirements of the above cited cases and, as noted *supra*, threatened to harm the *Journal's* reputation for professionalism and integrity.

Appellants may not successfully claim that they did not "cause" the use of interstate mail and wire communications for purposes of 18 U.S.C. §§ 1841 or 1843. It is sufficient that appellants knew that the use of interstate mail and wire services was a reasonably foreseeable consequence of the scheme. *Pereira v. United States*, 347 U.S. 1, 8-9 (1954); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981). Certainly appellants understood that the interstate mailings and wirings associated with the publication and distribution of the *Wall Street Journal* was "a normal and customary part" of that business. *Muni*, 668 F.2d at 90. Although the mailings and wirings did not result from the fraud itself, we agree with the district court that their

foreseeability and centrality to the scheme were sufficient predicates to allow a conclusion that appellants violated the mail and wire fraud statutes. Indeed, the mailings and wirings in this case were considerably more important to this scheme than were the incidental telephone calls by merchandisers in *Muni* for authority to make credit card sales.

Regarding the requisite specific intent to defraud under the mail and wire fraud statutes, it is sufficient that the district court found that Winans and Felis intended to deceive and defraud the *Journal*, and that Carpenter knowingly aided and abetted Winans and Felis in that effort. *See United States v. Gregg*, 612 F.2d 43, 50 (2d Cir. 1979) ("knowledge of and desire to assist the criminal activity of the principal and intent to injure or defraud" held sufficient).

III.

Appellants individually and collectively also make some collateral arguments, which we address in pertinent part below. Carpenter argues that his acquittal on the conspiracy charge is inconsistent with his conviction for aiding and abetting. The two crimes involve distinct standards of proof: the former requires "proof of a conspiratorial agreement," while the latter requires proof merely that a defendant "in some way associate himself with the venture, that he participate in it . . . [and] that he seek by his action to make it succeed." *United States v. Bommarito*, 524 F.2d 140, 145 (2d Cir. 1975); *see also United States v. Jackson*, 778 F.2d 933, 940 (2d Cir. 1985) (Friendly, J.) ("the offenses of conspiring and of aiding and abetting, while closely allied, are distinct"). We think that the district court properly applied these distinct

standards to, *inter alia*, Carpenter's knowledge of the scheme, his endorsement of checks, and his allowing Winans to trade in his name in the Merrill Lynch and Schwab accounts.

Nor are we persuaded that the evidence was insufficient to substantiate the district court's conclusions as to any of the counts, with one exception. We think the district court erred in holding Winans liable under counts 15, 20, and 23, to the extent that those counts involved Felis' trades on behalf of Felis' friend, Stephen Spratt. The district court found that "Felis used the information obtained from Winans beyond the scope of the original agreement." 612 F. Supp. at 835. The record evidence supports the conclusion that Winans' trading agreement with Felis was limited to specific persons. Winans, therefore, may not be found liable as to Felis' trades with or on behalf of Spratt, as to whom Winans had no agreement or knowledge. *Pinkerton v. United States*, 328 U.S. 640 (1946). However, we emphasize that Winans might have been liable for the Spratt trades had the scope of the trading agreement been broader, to include trading by or for persons other than the small group of conspirators herein, *see Pinkerton*, 328 U.S. at 646-47 (liability for acts of co-conspirator "in furtherance of the conspiracy"), or had the trades been "part of the ramifications of the plan which could . . . be reasonably forseen as a necessary or natural consequence of the unlawful agreement," *id.* at 648, or perhaps had Winans at least known of the Felis-Spratt relationship, *see United States v. Bennett*, 665 F.2d 16, 20 n.4 (2d Cir. 1981) (government "need prove only that the defendant was a member of the conspiracy and that the illegal acts lay within the scope of the conspiracy and were a foreseeable consequence of

it"). We further note that the Spratt counts were among the counts on which Winans received a sentence of concurrent probationary terms.

IV.

We conclude where we left off in *Materia*, that "[f]or all intents and purposes," the liability of Carpenter, Winans and Felis "was settled fifty years ago." *Materia*, 745 F.2d at 203. Congress' enactment in 1934 of a "comprehensive yet open-ended statutory scheme, capable of ongoing adaptation and refinement," *id.*, proscribes the misappropriation and deception that appellants perpetrated herein. To hold otherwise would undermine Congress' ideal in 1934 of "an open and honest market," *id.*, in which superior knowledge in the securities markets would be achieved honestly, fairly, and without resort to pernicious conduct.

Winans' conviction for conspiracy involving the Spratt trades is reversed. In all other respects, the judgment of the district court is affirmed.

MINER, *Circuit Judge*, dissenting in part:

Since I am of the opinion that the misappropriation theory cannot be interpreted so expansively as to encompass the activities of these defendants, I respectfully dissent from so much of the majority opinion as affirms the convictions for securities fraud.

Until today, the misappropriation theory of criminal liability for securities fraud was applied only in those

cases involving the taking and use of non-public, confidential, *securities-related* information by those who obtain that information through special relationships with their sources of knowledge. *S.E.C. v. Materia*, 745 F.2d 197 (2d Cir. 1984) (employee of printing establishment traded in securities on the basis of confidential takeover-target data stolen from his employer), *cert. denied*, 105 S. Ct. 2112 (1985); *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981) (employees of investment banks purchased securities on the strength of misappropriated confidential merger and acquisition information entrusted to the banks by corporate clients), *aff'd after remand*, 722 F.2d 729, *cert. denied*, 464 U.S. 863 (1983); *S.E.C. v. Musella*, 578 F. Supp. 425 (S.D.N.Y. 1984) (manager of office services for law firm improperly acquired tender offer information and traded on it in violation of fiduciary duty to firm and its clients). "[T]he theory premises liability on a party's deception of those who have given him privileged access to confidential information." Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 Hofstra L. Rev. 101, 124 (1984).

No confidential securities information imparted by reason of any special relationship was purloined by these defendants. The "Heard" columns written by Winans consisted of high quality, accurate articles dealing with the strengths and weaknesses of various securities, and the research data upon which the columns were based were fully available to the public. To say that the "publication schedule" of the Wall Street Journal was the non-public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b-5 beyond all reasonable bounds. Knowledge of publi-

cation dates simply is not the special securities-related knowledg implicated in the misappropriation theory. Moreover, it cannot be said that the schedules were secrets to which Winans always was privy, since he frequently did not know which writings would be published, when they would be published or even if they would be published.

While the proscription of fraudulent and deceptive practices in connection with the purchase and sale of securities is a broad one, it never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper. *Cf. A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2d Cir. 1967) (section 10(b) and rule 10b-5 were "designed to protect both investors and 'the public interest' "). It seems especially ludicrous for the government to contend that the court should enforce the Wall Street Journal's conflict of interest policy prohibiting employees from trading on the basis of pre-publication information while conceding that the Journal itself is not prohibited from trading on such information. Harm to reputation, rather than to securities markets or market participants, never has been recognized as a proper subject for redress under section 10(b) or rule 10b-5.

In sum, I do not believe that the securities fraud provisions were designed to prohibit the type of fraudulent conduct engaged in by these defendants. Such conduct is addressed adequately by the statutes establishing the mail and wire fraud offenses of which the defendants stand convicted. Under those statutes, it is sufficient for the imposition of criminal liability that an employee has failed to disclose to his employer *any material information* he is under a fiduciary duty to disclose. *Newman*, 664, F.2d at 19; *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981).

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 17th day of July one thousand nine hundred and eighty-six

Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **DAVID CARPENTER**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 17th day of July one thousand nine hundred and eighty-six

Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **KENNETH P. FELIS**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
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UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

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Docket No. 85-1312, 85-1313, 85-1314

UNITED STATES OF AMERICA,

- Appellee,

-v-

DAVID CARPENTER, KENNETH P. FELIS and R. FOSTER WINANS

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the Appellant - **R. FOSTER WINANS**

Upon consideration by the panel that heard the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

Elaine B. Goldsmith
Clerk

UNITED STATES of America

v.

R. Foster WINANS, David Carpenter and Kenneth P. Felis, Defendants.

No. SS 84 Cr. 605 (CES).

United States District Court,
S.D. New York.

June 24, 1985.

As Amended July 24, 1985.

William M. Tendy, Acting U.S. Atty., S.D.N.Y. by Peter J. Romatowski, New York City, for plaintiff.

Buchwald & Kaufman by Don D. Buchwald, New York City, for defendant Winans.

Mudge Rose, Guthrie, Alexander & Ferdon by Jed S. Rakoff, Howard W. Goldstein, Caroline A. Riggio, New York City for defendant Carpenter.

Brown, Wood, Ivey, Mitchell & Petty by E. Michael Bradley and I. Scott Bieler, New York City, for defendant Felis.

OPINION

STEWART, District Judge:

Defendants R. Foster Winans ("Winans"), David Carpenter ("Carpenter") and Kenneth P. Felis ("Felis") are charged in Counts Two through Sixty-One with participating in a scheme to trade in securities based on information misappropriated from the Wall Street Journal ("WSJ" or "the Journal"). The information allegedly stolen from the Journal was the timing, content and tenor of market-sensitive stories scheduled to appear in the paper. This conduct was allegedly in breach of a fiduciary duty owed to Winans' employer, Dow Jones & Co., the parent company of the Wall Street Journal. As such, Dow Jones was allegedly defrauded, and the indictment charges that these activities were in violation of

Sections 10(b) and 32 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78ff and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5, and the mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343. All three defendants are also charged in Count One with conspiracy to violate those statutes and to obstruct justice by their agreement to cover up and obstruct any investigation of the scheme by disguising payments, by making false statements to Kidder Peabody, the WSJ and officers of the SEC, and by preparing false documents intended for submission to the SEC. Peter Brant, not a defendant in this action, is also named as a conspirator.[1]

Winans was a reporter at the Wall Street Journal, and one of the writers of the "Heard on the Street" column ("the *Heard* column"). Winans and Carpenter are homosexuals who have been involved in what they describe as a "spousal relationship" for over ten years. Carpenter also worked at the Wall Street Journal, but for a briefer period of time than Winans. Felis was a stockbroker at Kidder Peabody, who was brought into that brokerage firm by Peter Brant, the government's key witness in this prosecution. It is fair to say that Winans and Brant were the chief architects of this trading arrangement.

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1. Brant pleaded guilty to an information in another action (84 Cr. 470) and in connection therewith entered into a plea agreement requiring his testimony in this prosecution. After the trial concluded, the government disclosed some additional evidence concerning the accounts of two of Brant's clients, Roger Wilson and David Clark. As indicated at the hearing on June 13, 1985, these new matters, summarized in the government's letter of June 10, 1985, have been considered in connection with Brant's credibility.

I

After a twenty-day trial, we find the facts as follows. Winans was originally hired by the Dow Jones News Service in late March 1981. Referred by Winans, David Carpenter was hired by Dow Jones as a news clerk in December of 1981. Beginning on February 2, 1981, it was the practice of the Journal to distribute to all new employees "The Inside Story," a forty-four-page pamphlet with seven pages devoted to the conflicts of interest policy. Winans denied ever receiving this booklet, or any other written conflicts policy, although he testified to receiving benefits information at the time of hire; "The Inside Story" does contain data on benefits, but Winans testified that the form of benefits information he received was distinct from this particular pamphlet. As for Carpenter, who worked at the Wall Street Journal for approximately one and a half years, the government offers the same general practice testimony. However, Ms. Malloy, Personnel Manager for the New York region of Dow Jones, could not recall if she followed that practice with Carpenter, even though she was the one who conducted his orientation.

Winans received a promotion in the summer of 1982 when he became one of two full-time "Heard on the Street" writers. This column, the focus of the case, is a daily market gossip feature, which highlights a stock or group of stocks and analyzes notable volumes of trading or price movements occurring in the market. The *Heard* column reports both negative and positive information about its featured stocks, but also takes a point of view with respect to investment in the stocks that it reviews. Numerous witnesses, including Winans, testified that t column has an effect on the price of stocks mentioned in the column.[2] Testimony was presented by the defendants concerning the investment thesis of each column at issue in an attempt to show that price movements were related to factors other than the column's publication. We find that the *Heard* column does have an impact on the market, difficult though it may be to

2. There is no claim that the column generally, or that any column in particular, contained corporate inside information or any hold for release material.

quantify in any particular case. It is certainly obvious that the defendants believed that the column had such an impact.

The Dow Jones Conflicts of Interest Policy is a three and one-half-page statement. It covers a number of subjects and specifically forbids the purchase or sale of securities on the basis of articles an employee knows will appear in the newspaper; it also states that employees should not disclose the paper's future contents to anyone outside the company. The policy also states that "all material gleaned by you in the course of your work for Dow Jones is deemed to be strictly the Company's property." Winans denied knowledge of any conflicts of interest policy, written or verbally conveyed, although he admitted that maintaining the confidentiality of the contents and timing of the columns was a "practice" of which he was aware.

Stewart Pinkerton, the New York Bureau Manager at the time of Winans' hire, testified to a conversation in which he told Winans of the confidential and sensitive nature of the *Heard* column, as well as the essentials of the conflicts of interest policy. Winans testified that this meeting was a brief "welcome aboard" talk, in which he and Pinkerton discussed salary and exchanged platitudes. Richard Rustin, who was Assistant Chief of the New York bureau and Winans' supervisor on the *Heard* column, testified that he too told Winans of the sensitivity of the column, and the importance of not investing in stocks the writer is covering. He also cautioned Winans that he should not let sources know what would be appearing in the column. Both Pinkerton and Rustin testified to follow-up reminders about the confidentiality of the column, after hearing rumors of leaks or having overheard Winans speak inappropriately to sources. Winans denies these conversations as well.

Seven months after Winans started to write the *Heard* column, on April 14, 1983, Pinkerton wrote Winans, summarizing a job performance discussion about errors in Winans' columns. Pinkerton wrote:

> As you were made aware last August when you were hired to do the Heard on the Street Column, it's one of the most important columns we run. People rely on its insight, accuracy and integrity. When trust begins to erode on anything the

> Journal does, it creates grave concern, but especially so with something as sensitive as the Heard column.

Moreover, shortly after Winans' move to the *Heard* column, on August 19, 1982, he wrote Pinkerton a letter disclosing his free-lance activities and his plans to withdraw from them. Both these documents support Pinkerton's testimony that he and Winans had a substantive discussion about the ethical responsibilities associated with the *Heard* column and conflicts of interest in general.

We find that Winans had actual knowledge of the policy with respect to maintaining the confidentiality of the column. His testimony carefully used the word "practice" as opposed to "policy," but the factual distinction is meaningless. Winans knew he would be fired if his conduct came to light. He knew that part of his job responsibilities were to keep the subject matter and the publication date of the column secret. He discussed the topic with his co-writer, Gary Putka, and cautioned a new writer, Ed Leefeldt, not to be too obvious about the column's subject when dealing with sources. Winans also knew that he was supposed to tell his editors if he heard that word was out about a column's topic. He told his editors about one leak prior to his arrangement with Brant. Even during the course of the scheme, while deliberately tipping to Brant, he went to his editor to say that a source was aware that they were working on a certain column. On neither occasion did the editor choose to kill the column, but Winans knew that it was part of his job to allow his employer that option.

Defendants argue that there is a legal significance to a distinction between the violation of a policy and the failure to adhere to a practice. The legal argument will be addressed below, but we believe it is unnecessary for us to make the fine, factual distinctions between knowledge of a policy and knowledge of a practice that the defendants would have us make. In any event, we accept the testimony of Pinkerton and Rustin. We also find incredible Winans denial that he ever received the conflicts of interest policy statements.

As for David Carpenter, the government argues that he too knew of the policy from his work as a news assistant on the

national news desk. According to the testimony of Nancy Cardwell, the Night News Editor who supervised him at the time, part of Carpenter's job was to answer the phones. She testified that in performing that task, he often had to deflect callers who sought to learn about the appearance of an article. Sometime in January of 1983, Carpenter asked Cardwell how to look up the stock symbol for American Surgery; he said "that's my stock" and over the next few weeks, she noticed he would frequently check the price. She believes at some point he commented, "Foster likes that stock," but for all she knew, that meant Winans had written a column about it and he had read it. We find that Carpenter was aware generally of the policy.

The American Surgery investment is the first overt act alleged in the conspiracy count, although it is not charged as a substantive crime. In early January of 1983, Winans started looking into the company in connection with a possible article. On January 10 or 11 he purchased American Surgery stock for a brokerage account held in David Carpenter's name, at a total cost of $1,814.17. Two favorable *Heard* columns were written about the company and published on January 13, 1983 and March 23, 1983; the 400 shares of stock were sold on May 17, 1983 for $4,673.64. Similarly, he bought 1,000 shares of Institutional Investors stock in Carpenter's account on April 28, 1983, and a favorable article appeared on June 1, 1983; the Institutional Investors stock was sold five days later. A $497.59 profit was made on the initial $1,237.50 investment in Institutional Investors.

The government seeks to use the early trades in American Surgery and Institutional Investors as the beginning stages of the conspiracy, which Brant and Felis joined later, providing the know-how in securities trading and large-scale capital. While we are not persuaded by Winans' testimony that these purchases and sales were investment decisions entirely independent of the WSJ articles, we do not believe that any conspiratorial agreement existed at this time between Winans and Carpenter. The account at Merrill Lynch and the subsequent account at Charles Schwab & Co., Inc. (in which these trades were made) were in Carpenter's name, but Carpenter's involvement in the trading decisions was minimal. Winans filled out the applications for the accounts, and either told Carpenter what trades to make or

made them himself, identifying himself as Carpenter over the phone. Although Winans was keenly aware of the impropriety of the trading, we cannot accept the government's view of this trading as pursuant to a conspiracy between him and Carpenter.

American Surgery remains significant in that it indirectly led Winans to Peter Brant, when Mark Delotte, a public relations consultant for that company, put the two in touch. Delotte suggested Brant as a possible focus of an article about superbrokers. Brant was the number one broker at Kidder Peabody, with a commission income of $1.8 million for the fiscal year December 1982 through November 1983. Brant and Winans met for the first time in mid-May of 1983. While Brant was not enthusiastic about a possible article featuring him, they met again on June 1, 1983 to tour the Racquet Club and have dinner at "21". A third meeting on June 14 was intended to be an opportunity for Winans to observe Brant meeting with a new client, but the potential client cancelled; instead, the meeting was another general chat about investing philosophies and lifestyles. At all of these initial meetings, the discussion related to Brant's phenomenal market success, his personal wealth and flamboyant lifestyle.

From June of 1983 on, Brant became one of Winans' regular sources. He was quoted in an August 31, 1983 article, and quoted again, but not identified, in a September 2 column. Brant also invited Winans to a July 4th party on his boat, but Winans declined.

Brant and Winans present conflicting stories with respect to the birth of the scheme. Both testified to an October 12 meeting at the Racquet Club. According to Brant, nothing particularly significant took place that day, although there had been previous conversations in which he remarked to Winans about the coincidence of his own trading in two stocks, Apple Computer and Widergren, which later became subjects of *Heard* columns. Winans testified expansively to a meeting in which Brant turned the topic of conversation away from the broker and on to the reporter; they talked about Winans' work, career goals and financial situation. Winans testified that Brant brought up the coincidental trading in Apple more pointedly.

According to Winans, Brant directly said, "You know, if I knew beforehand what was going to be in the column, we could make a lot of money." Winans testified that although the statement was made lightly, there was no doubt in his mind that Brant was not joking, but was making an offer. Brant denies this entirely.

This conflict in the testimony need not be resolved, since it is undisputed that the next weekend, Winans went out to Brant's house, and the two struck a deal on Sunday, October 16, 1983, on the Meadowbrook golf course on Long Island. They agreed that Winans would leak information to Brant with respect to the timing, subject and tenor of *Heard* columns so that Brant could trade in securities armed with that information. Both testified that it was part of the agreement that the arrangement would not affect the journalistic purity of Winans' writing. On Winans' side, the agreement would not influence his choice of topic or the contents of any article; he would continue to write balanced pieces, containing both negative and positive information. Brant was told that occasionally columns were killed or delayed because of a superseding newsworthy item. On Brant's end, the timing, volume and type of trading was totally in his hands. As for the distribution of profits, it seems to have been assumed that net profits were to be split after fifty percent was set aside for taxes. It also appears to have been assumed that Winans would receive nothing if there were no profits.

Brant states that Winans described Carpenter as someone he was close to, who would know of the arrangement. In response, Brant asked if Carpenter could be trusted; Winans assured him on this point. Winans testified that his reference to Carpenter was intended to let Brant know that he was a homosexual as well as to see if there was any possibility of a part-time job for Carpenter. Brant says that he told Winans about Felis at that time, describing him as a business partner who would also participate; Winans testified that Brant told him about Felis a day or two later over the phone. Lastly, it was agreed that Brant would advance Winans $15,000, and that the check should be made out to Carpenter to avoid using Winans' name.

On that Sunday afternoon, Brant called Felis to tell him of the arrangement; Brant testified that Felis was enthusiastic.

Winans went home and told Carpenter that he was going to be giving Brant stock ideas he picked up in his work and Brant would be giving him money. Carpenter's SEC testimony similarly reflects that, at first, Carpenter only knew of a business arrangement between Brant and Winans in the most general sense.

The following week, the agreement was put into effect. The advance from Brant was delivered to Winans; the $15,000 check was tucked inside a Kidder Peabody research report. Carpenter endorsed the check, and Winans deposited it the following day in their joint checking account. That Monday, October 17, 1983, Winans leaked to Brant that the *Heard* column for Tuesday was to be a positive column on oil drilling stocks. Stock and options in Schlumberger, Ltd., one of a number of companies mentioned, were bought in two accounts, one in Brant's name and a second in Felis' name, the latter jointly owned by Brant and Felis. The scheme began inauspiciously, when a more newsworthy article came up, and the oil drilling column was displaced and delayed by a day. The first trade resulted in a loss of $37,914.25 in Felis' account and $9,550.53 in Brant's account.

On October 18, 1983, Brant included David W.C. Clark, a client and friend, in the deal. Brant testified at trial that Clark was depressed and suicidal one night, and Brant told him of the plan and its profit potential in order to cheer him up. Felis' reaction to this addition was to state that "Clark is a pig and he'll get us all caught." Brant traded on information from Winans in Clark's accounts at Kidder Peabody beginning on October 19, 1983 despite this lack of enthusiasm. Winans was never aware of this trading, which is not included in any of the substantive counts; Winans only learned of Clark's existence at the time the SEC started asking questions.

The second trade was in TIE/Communications, Inc., and resulted in a profit of over $100,000 in the Felis and Clark accounts. On October 20, 1983, Winans, Brant and Felis met for drinks at the Racquet Club and went out to dinner. The group discussed that there was a better profit potential in columns focusing on one stock, such as the column on TIE, rather than a column about a group of stocks, such as the mention of

Schlumberger as one of a number of oil drilling companies. Felis suggested a flat fee of $25,000 per story for Winans. There was also some discussion about being careful not to attract attention.

The following weekend was spent at Brant's home again, with Carpenter accompanying Winans on this occasion. Apparently little business conversation took place, and Brant recalled none. In contrast to Brant's lack of recall, Winans and Carpenter testified to a conversation on the same golf course, but both Winans, at trial, and Carpenter, in his SEC testimony, described it as a general discussion about stocks and making a lot of money.

From this point in October until the end of February 1984, approximately twenty-seven articles were leaked in advance, not all of which were written by Winans. When the topic was set for the next day, Winans would call Brant. Winans could only recall one specific instance in which he called Felis, in connection with a story on Chicago-Milwaukee, although he thought that he may have called Felis additional times. His calls were generally made from a pay phone outside the WSJ building. He also used the name "Howard Cohen," or variations thereof, when calling Brant. Apparently, he was not very good at remembering his false name and sometimes identified himself as Howard Kahn or Howard Winans.

The execution of the trades was entirely left to Brant, who testified that he would discuss the strategy with Felis and/or Clark. Depending on the positive or negative tone of the article, stock was either bought or sold short, and call or put options were either bought or sold. Most often, the transactions were closed on the same day as an article's publication, thereby maximizing its impact. The net profits amounted to almost $690,000, taking into account trading in all the accounts connected with the defendants.[3]

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3. These accounts were in the following names: Clark, Felis, Carpenter, Winans, Western Hemisphere, Spratt and Brant.

The distribution of profits was far from mathematically exact; it may be a coincidence that the $30,000 paid to Winans actually does reflect a one-third share of the after-tax profits from the Felis and Western Hemisphere accounts. Brant would generally inform Winans about making money on trades, but Winans does not appear to have been keeping careful track. He asked for money when he needed it. On November 10, 1983, Brant gave Winans 750 British pounds for Carpenter to use on his trip to London. On December 7, in response to another request from Winans in connection with a specific need, Brant wrote a check for $5,000. The last payment was a $10,000 check issued on January 26, 1984.

The $10,000 check written on January 26, 1984 has the handwritten notation "drapes" on it. Brant asked Felis to write the check. Since it was the first check Felis made out for Winans, he asked "What should I write on this thing, drapes?", to which Brant responded "Yes." While Brant initially testified that this justification for the payments had been previously discussed at his house, in a conversation between Felis, Carpenter and himself, he ultimately backtracked and equivocated, admitting that any such conversation that included both Carpenter and Felis might have taken place after the check was drawn; Brant did state that it was definitely discussed at a February 11, 1984 meeting. However, testimony from Gary Lickle, Brant's friend and attorney who was at the house that weekend, established that on February 11, Carpenter, Brant and Felis never had a private conversation. While this testimony is significant with regard to Carpenter, it means nothing with respect to Felis' knowledge at the time the check was written. He must have had some sort of conversation with Brant at the time he wrote the check, and it is irrelevant whether Brant told him to write the word "drapes" on the check or whether Felis brought it up. As Felis was aware, the check was not for decorating services; the addition of the word "drapes" was to establish a basis for saying that it was.

Nor do we understand defendant Felis' explanation that, in light of Brant's testimony that someone, maybe Carpenter, felt a need to have an explanation of how the payment should be declared as income for tax purposes, the worst this notation shows is a scheme to defraud the IRS. The fact remains that

Brant and Felis recognized that there was a problem with the true source of the income, necessitating a false explanation for the payment.

Felis, Brant and Winans met two other times in addition to the October 20 meeting: once at the Racquet Club followed by dinner at Cafe Seiyokin in late October or early November, and once at Brant's house the weekend of February 11, 1984. Carpenter, Brant and Winans met a total of three times: during the October 22 weekend, for drinks and dinner in November of 1983, and during the above-mentioned February 11 weekend accompanied by Felis as well. After the Cafe Seiyokin evening, Winans objected to further meetings at the Racquet Club for fear of running into Wall Street or Wall Street Journal acquaintances.

The government argues that during the agreement's operation, the contents of three of Winans' stories were affected by the conspiracy, in that Winans pushed for publication of articles on Todd Shipyards and Petro Lewis over the objections of his collegue, Gary Putka, who disagreed with the contents and tenor thereof. However, those two instances appear to be only examples of a routine difference of opinion between Winans and Putka. If anything, the fact that the government has the opportunity to make this argument points out the difficulty of maintaining a stance of journalistic purity when the reporter is engaged in a decidedly unpure venture.[4]

More troubling is Winans' testimony at the SEC with respect to his January 19, 1984 article on Digital Switch. Digital Switch was a stock that had helped to make Brant rich. He was heavily invested in the stock, and it was not doing well.

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4. Maintaining the journalistic purity of the column was actually consistent with the goals of the conspirators. As Winans testified, a particularly compelling column or a fresh investment thesis would have a significant impact on the price of the featured stock. As he stated, "The impact on the market told me the column was good." However, if false or slanted articles were published, the column's readers would very likely lose confidence in the column and cease to rely on it. As a result, its otherwise predictable impact on the market would be lost to the detriment of the conspirators and the possibility of discovery of the scheme by Winans' superiors would be enhanced.

Indeed, both the government and the defendants point to the poor market status of this stock as Brant's motive for entering into the arrangement. Winans unequivocally testified at the SEC that Brant's promise of a big distribution of profits if he could get out of Digital Switch was "an inducement" and a factor in his choosing to write the January 19 article. At trial, Winans testified that he was trying to be helpful at the SEC, that this was the only time that Brant had connected their agreement with a story idea, and that in his SEC testimony he misspoke. While Brant may have been offering an inducement, Winans testified that the inducement did not affect his journalistic judgment in choosing to write the article; it was a newsworthy column which was written for that reason. That may be the case, but we do not accept his rejection of his SEC testimony; rather, we accept it as evidence of Winans' criminal intent.

Trading by Winans also continued in Carpenter's Schwab account during the time in which Winans was profiting from Brant's trading. Six trades took place in the Carpenter account, each on the day before an article appeared in the Wall Street Journal. Like the earlier trading in American Surgery and Institutional Investors, Carpenter's role in this trading was primarily ministerial, although as indicated in his SEC testimony, he was aware that these purchases and sales were connected with the appearance of articles in the Journal.

Felis used the information obtained from Winans beyond the scope of the original agreement. The topic and tone of forthcoming *Heard* articles was passed by him in seven instances to Douglas McCaskey, a stockbroker and an old college friend of Felis. Similarly, Felis tipped Stephen Spratt, his junior partner in his Connecticut business in four instances. Spratt's broker noticed the correlation between Spratt's transaction and a WSJ article in one such trade. Spratt called Felis, who said "you better change your account." Felis, in an obvious effort to conceal the conspiratorial scheme, told him to move accounts because his broker would start copying his trades, and Spratt would not get good service. At trial, Spratt also testified that Felis told him that there was nothing wrong with the trading, that it was just one of Brant's tips, and that an attorney had said it was legal; Spratt made no mention of this latter part of the conversation when he testified before the SEC.

On November, 3, 1983, Kidder Peabody's Compliance Department noticed correlation between *Heard* articles and trading in the Felis and Clark accounts. William Kennedy, New York Regional Manager for Kidder Peabody, asked Brant and Felis about the trades. Felis falsely stated that he was merely copying the trades of Clark, who Brant asserted got his information from friends on Wall Street. Brant also falsely denied knowing anyone at the WSJ. Kennedy said that Felis' trading had to stop, and told Brant and Felis that he was going to seek legal advice with respect to Clark's unsolicited trades.

As a result of that meeting, Brant and Felis liquidated the Felis account and had a Kidder Peabody $275,000 check drawn to Morgan Guaranty. On November 4, 1983, the Kidder Peabody check was exchanged for a bank check payable to "Western Hemisphere Trade Corp. No. 2"; no transaction is reflected in Felis' account. Brant had already telephoned the Bank Institute of Zurich and made arrangements to open an account in the Western Hemisphere name in Switzerland.

Felis had already arranged a trip to Europe and opened the Swiss bank account in November while abroad. The Western Hemisphere Trade Corp. money was wired back to a new Kidder Peabody account, and trading on Winans' information continued, except now it was in the name of Western Hemisphere rather than in Felis' account at Kidder Peabody. Ultimately, the money from the Western Hemisphere account was split between Brant and Felis when the account was closed in March 1984.

After the November 3 meeting, Robert Krantz, the General Counsel of Kidder Peabody, asked the law firm of Sullivan & Cromwell for an opinion on the legality of Clark's trading. A preliminary memorandum was written at the law firm on the premise that Clark had an inside source at the WSJ. The memorandum concluded that Clark would be subject to criminal and SEC enforcement proceedings and might be subject to civil liability. Though the memorandum was a preliminary one, and the partner in charge at Sullivan & Cromwell was not entirely satisfied with it, Krantz went to see Clark (who is a lawyer) to stop the trading. He and Clark met on November 17, 1983, and he told Clark about Sullivan &

Cromwell's conclusions. Clark denied having any source at the WSJ. The upshot of the encounter was that Clark stated that Brant was not being very helpful, and that he intended to move his trading to another brokerage firm. In fact, he did open an account at Bear Stearns and continued to trade on Winans' information.

Krantz's next stop on that day was to see Brant to explain why he had just encouraged one of Brant's valuable clients to take his business elsewhere. Krantz described his intentions as "handholding." By the time he got there, Brant told him that Clark had already called to say he was going to discontinue his trading. At this meeting, which Felis joined, Krantz recalled telling Brant and Felis that he did not know if the trading was legal or illegal, but "he had begun to think that there was some type of violation involved here if the material was in fact coming from the WSJ." Krantz was not sure if he specifically said anything about the Sullivan & Cromwell memorandum and its conclusions. When Brant asked him if they had done anything wrong, Krantz responded that he did not think so, and that he was not sure that Clark had done anything wrong either in light of *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983). However, the entire conversation was premised on the assumption that if anyone had a tie to the WSJ, it was Clark, and all Brant and Felis had done was execute unsolicited orders and copy the trades. Nor did Krantz have any idea that there was a systematic plan to advance information with a Wall Street Journal reporter sharing in the profits.

On March 1, 1984, the SEC, having commenced an investigation, called Clark, who promptly informed Brant, who then passed the word along to Felis. Clark gave false answers to the agency's questions about the trading; he told the investigators that he had several sources on Wall Street. He told Brant he had sent them "up some blind alley" by mentioning unconnected individuals and brokerage firms. Clark also told them he did not know Winans. On the same day, Winans was called into a Wall Street Journal executive office, where Mr. Pearlstine, Managing Editor of the Journal, and Robert Sack, counsel to the Journal, were also present. Although Winans was warned about the ramifications of giving false answers, he gave a number of patently untruthful responses to the SEC's questions.

Specifically, he denied having any interest in a brokerage account in someone else's name and denied having received any money from Peter Brant.

That night, Carpenter called Brant and said that "the drapes are not hanging right," a none too subtle reference to the $10,000 check written by Felis a little over a month earlier. Winans sent Carpenter to meet Brant with a note reflecting what had been asked by the SEC and what his responses had been. Winans testified that the use of a written narrative was not part of any surreptitious plan to get their stories straight, but a reflection of his own lack of faith in Carpenter's memory; we accept his testimony that he did not want to rely on Carpenter's memory, but we reject the balance of this testimony. He also testified that he did not want the notes left with Brant. Carpenter and Brant met at Brant's Manhattan apartment. Upon learning that Winans denied receiving any money from Brant, Brant remarked that it was a good thing that the checks had been written out to Carpenter. To his dismay, he learned for the first time that the checks had been deposited in Carpenter's and Winans' joint checking account. Carpenter tried to get information from Brant about some of the names that the SEC had questioned Winans about, specifically Clark, and Brant's response was evasive. It is also unclear whether it was at this or a subsequent meeting that the preparation of false invoices to justify the payments as decorating services was discussed.

Winans met with Dow Jones attorneys and executives on March 2, 1984. At this point, there was no suggestion that Winans was involved in any improper conduct, and Winans did not tell his employer the truth. Over the following weekend, Carpenter went to Brant's Long Island home with another written narrative of Winans' conversations. At this time, Winans was aware that the checks were to be justified by attributing them to payments for decorating services. He knew that Brant and Felis were putting pressure on Carpenter to prepare fake invoices to support that explanation.

Brant himself was contacted by the SEC on March 5, and he too did not tell the truth. A plan to go to Brazil with David Clark was made, but not carried out. In mid-March, Brant

went to Florida with his family. Meanwhile, Winans hung on at the Wall Street Journal. Although he testified that he was suicidal during this time period, Winans was actually engaged in pursuing a new job outside the Journal and was even haggling with his employer about severance pay in mid-March.

The SEC investigation became formal on March 14. On March 21, 1984, Brant, Felis and Carpenter had a lunch-time meeting in New York. There was further discussion about the invoices, with an instruction from Felis not to have them in sequential order in light of the lapse of time between checks. That same night Brant, Felis, Carpenter and Winans met at Trader Vics in the Plaza Hotel. Carpenter finally produced the invoices either that evening or sometime earlier that afternoon; these documents are clumsily executed and are unsigned and undated.

The Trader Vics meeting was highly emotional. Winans was only there for part of the time, and Brant reassured him that nothing would happen. Brant said that he could say that in the course of his conversations with Winans as a source, he figured out what Winans was working on; the payments to Carpenter were explainable as decorating expenses. Carpenter had been drinking and was slightly hysterical. After Winans left, Carpenter, Felis and Brant got into a fight. Carpenter made vague threats about backing from gay and journalistic organizations. Brant and Felis tried to calm him down and made similar vague threats about the necessity of sticking to the story.

According to Winans' SEC testimony, Winans and Carpenter no longer trusted Brant and Felis. On March 29, Winans and Carpenter voluntarily went to the SEC and testified fully about the scheme.

II

The conspiracy count alleges a scheme beginning on or about January 1, 1983 and running until March 29, 1984. The defendants are alleged to have conspired to commit securities fraud, mail fraud and wire fraud, and to obstruct the SEC investigation by engaging in a cover–up and by making false statements to Kidder Peabody, the WSJ and the SEC. The January date for the birth of the plan reflects the government's view that the conspiracy originated between Winans and Carpenter. The early trades in American Surgery and Institutional Investors are the first overt acts identified in the indictment.

It is well–settled that the crime of conspiracy is an illegal agreement among conspirators for which a "meeting of the minds" is required. *See generally United States v. Rosenblatt*, 554 F.2d 36, 38 (2d Cir. 1977). There must be agreement as to the "essential nature" of the plan, and a "general agreement to engage in unspecified criminal conduct is insufficient to identify the essential nature of the conspiratorial plan." *Id.* at 38–39. Mere presence at the scene of a crime or mere association with conspirators is not enough to show membership in a conspiracy. *United States v. Martino*, 759 F.2d 998 (2d Cir. 1985). There must be some evidence that the defendant "associat[ed] himself with the venture in some fashion, 'participate[ed] in it as something that he wish[ed] to bring about,' or, [sought] by his action to make it succeed.'" *United States v. Johnson*, 513 F.2d 819, 823 (2d Cir. 1975) (quoting *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938).

Counts Two through Twenty–Five charged that the defendants "unlawfully, wilfully and knowingly, directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, did (a) employ devices, schemes and artifices to defraud, and (b) engage in acts, practices and courses of business, which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Company, Inc., in connection with the purchase and sale of securities" in violation of 15 U.S.C. §§ 78j(b), 78ff, and Rule 10b–5 promulgated thereunder. 17 C.F.R. § 240.10b–5. Each count relates to a

specific transaction, with the first trade in Schlumberger, Ltd. taking place on October 17, 1983.[5]

The prosecution's theory in support of these securities counts is known as the misappropriation of information theory, which had its genesis in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). Chiarella was a mark-up man at a financial printing firm. In the course of his employment, he deciphered the identity of companies targeted for takeovers or mergers, purchased stock in those companies and sold immediately after the plans became public, thereby making a substantial profit. Although his conviction was affirmed by the Second Circuit, the Supreme Court reversed, holding that Chiarella owed no duty to disclose his inside information to the sellers of the securities.

The Second Circuit had held that not only did Chiarella have such a duty to the sellers, but the Court also commented that he had breached a duty to his employer. In a footnote, the Court stated that the indictment

> not only alleged that appellant's activities "operated as fraud and deceit upon the sellers of the aforementioned securities," it also charged a "scheme to defraud" in general terms. Clearly, violation of an agent's duty to respect client confidences, Restatement (2d) Agency § 395, transgresses Rule 10b–5 where, as here, the converted information both concerned securities and was used to purchase and sell securities.

United States v. Chiarella, 588 F.2d 1358, 1368 n. 14 (2d Cir. 1978), *rev'd*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). The Supreme Court refused to address the merits of the misappropriation theory on the ground that it had not been properly presented to the jury. *Chiarella, supra*, 445

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5. While Winans is named in all of the counts, Felis and Carpenter are not charged with each transaction. This is also true for the mail and wire fraud counts. With respect to the securities fraud counts, the government at the close of its case, dropped counts 19 and 25 charged against defendants Winans and Felis.

U.S. at 236–37, 100 S.Ct. at 1118–19. In a dissenting opinion, Justice Burger (who believed the issue was properly before the court) heartily endorsed the Second Circuit approach, arguing that securities fraud need not only be premised on a relationship between the buyer and seller:

> In particular, the rule should give way when an informational advantage is obtained, not by superior experience, foresight and industry, but by some unlawful means. . . . I would read §10(b) and Rule 10b–5 to encompass and build on this principle: to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading.

Id. at 240, 100 S. Ct. at 1121 (Burger, J. dissenting). Justice Brennan, concurring in the judgment, agreed with Justice Burger's presentation of the misappropriation theory, but thought it was not adequately charged. *Id.* at 239, 100 S.Ct. at 1120. Justices Blackmun and Marshall, dissenting, agreed generally with the Chief Justice's dissenting opinion, but thought that the theory was unnecessary to sustain the conviction. *Id.* at 245, 100 S.Ct. at 1123. The last hint of the Supreme Court's view of this alternative theory is found in Justice Stevens' concurrence, in which he remarks that "respectable arguments could be made" both in favor of and against the theory, but "[t]he Court wisely leaves the resolution of this issue to another day." *Id.* at 238, 100 S.Ct. at 1120.

October 31, 1981 was the day the Second Circuit cast its vote in favor of the theory in a case in which employees of investment banking firms "misappropriated confidential information concerning proposed mergers and acquisitions that was entrusted to their employers by corporate clients." *United States v. Newman*, 664 F.2d 12, 15 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, ___U.S.___, 104 S.Ct. 193, 78 L.Ed.2d 170 (1983). Trading was effected surreptitiously and substantial profits were made. The Circuit reversed the District Court's dismissal of the indictment, which charged the defendants with securities fraud, mail fraud and conspiracy. The court did not require that a fraud be

perpetrated against either the buyer or seller of a security. Rather, the court found a fraud perpetrated against the employer sufficient:

> The wrongdoing charged against appellee and his cohorts was not simply internal corporate mismanagement. In *United States v. Chiarella*, Chief Justice Burger, in dissenting, said that the defendant "misappropriated–stole to put it bluntly–valuable nonpublic information entrusted to him in the utmost confidence." That characterization aptly describes the conduct of the connivers in the instant case.
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> Had appellant used similar deceptive practices to mulct Morgan Stanley and Kuhn Loeb of cash or securities, it could hardly be argued that those companies had not been defrauded. By sullying the reputations of Courtois' and Antoniu's employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money.

Id. at 17 (citations omitted). The opinion also states that Newman and his colleagues wronged the clients of the investment banking firms, "whose takeover plans were keyed to target company prices fixed by market forces, not artificially inflated through purchases by purloiners of confidential information." *Id.*

More recently, the Second Circuit reaffirmed its acceptance of the misappropriation theory in a case which was *Chiarella's* facts revisited. *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, ___U.S.___, 105 S.Ct. 2112, 85 S.Ct. 477 (1985). Materia was a copyholder in a financial printing firm, who also learned how to fill in the blanks in tender offer documents handled by his employer. He too purchased the target companies' securities and made substantial profits when the offers were made public. The Court firmly restated the essential holding of *Newman*: "one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b–5." *Id.* at 203.

Winans is said to have misappropriated a certain type of market-sensitive confidential information—the nature and timing of Wall Street Journal articles. The theft of this information is said to have operated as a fraud on the Wall Street Journal, which was in connection with the purchase and sale of securities in the featured stocks.

Relying on a number of arguments, defendants distinguish *Newman* and *Materia* on the grounds that Winans' conduct is entirely different and is not a proper basis for a securities fraud violation. First, they argue that the premise of both *Materia* and *Newman* was that the employees in those cases had not only stolen information from their employers' clients—the acquiring companies. Without such a third party, to find Winans' conduct to be a misappropriation of information would lead to what they perceive as a major inconsistency—the Wall Street Journal could trade on such information because it could not misappropriate information from itself.[6] In contrast, the employers in both *Newman* and *Materia* would not have been able to trade on the information, since they would still be misappropriating information from their clients.[7]

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6. We do not see why it is such an anomaly that an employer and an employee could not be prosecuted under the same theory. We agree with the government that this argument is reminiscent of Chiarella's unsuccessful Second Circuit claim that because a tender offeror could purchase up to 5% of the target stock without disclosure, he too should be allowed to trade prior to a public announcement. *United States v. Chiarella*, 588 F.2d at 1366. It was in the course of explaining why Chiarella should not be treated like the offeror that the court discussed the alternative misappropriation theory.

7. The first indictment filed in this case alleged that Winans "violated his duties owed to the readers of the Wall Street Journal, including a duty to disclose that Winans and his co-conspirators had traded in securities knowing that the Wall Street Journal would publish articles written by Winans or others concerning those securities; that Winans and his co-conspirators traded in such securities expecting that such columns or articles would affect the price and with the intent to profit from the change in price and that Winans and his co-conspirators intended to and did trade in such securities by selling their stock or options or covering short sales immediately after such columns or articles appeared, with the intent to profit from the change in price." The defendants argue that when the government dropped the theory resting on a duty to the WSJ readers, it lost its ability to follow the analysis of *Materia and Newman*. We disagree for the reasons stated in the text.

First, we note that the language of both *Materia* and *Newman* strongly supports a reading that the existence of third parties is not an essential element. The *Newman* decision discussed the wrong to the employer as a separate matter with the wrong to the clients mentioned as an additional point: the focus of the holding was on the fiduciary relationship between employer/employee. *See Newman, supra*, 664 F.2d at 17–18. While the *Newman* facts involved an additional harm to a third party, the case nowhere states that the harm to the employer must also encompass some harm to a client. Similarly, in *Materia*, the court emphasized the fraud on the employer and not whatever wrong was committed against the client:

> Among a financial printer's most valuable assets is its reputation as a safe repository for client secrets. By purloining and trading on confidences entrusted to Bowne, it cannot be gainsaid that Materia undermined his employer's integrity. . . Accordingly, we are driven to the conclusion that, by his misappropriation of material nonpublic information, Materia perpetrated a fraud upon Bowne.

745 F.2d at 202 (citation omitted). Once again, the facts included some harm to a third party, but the language of the case in no way implies that the misappropriation theory requires anyone outside the employer/employee relationship to have been affected. While the defendants phrase the distinction in terms of the existence of a contractual relationship, trying to confine *Materia* and *Newman* to the facts in this way is an implicit return to the view that a securities fraud can only be perpetrated against a buyer or seller of securities, a view clearly rejected in *Newman*. 664 F.2d at 17.

To support the argument that a client is a necessary figure in the misappropriation theory, defendants rely heavily on *Dirks v. SEC*, 463 U.S. 646, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983). Dirks was an investment analyst who received material, non-public information from insiders of Equity Funding, which indicated that the assets of the corporation were "vastly overstated as the result of fraudulent corporate practices." *Id.* at 649, 103 S.Ct. at 3258. Although he himself did not trade on

the information, he disclosed it to a number of clients and investors who sold their holdings in Equity Funding. The *Dirks* opinion attempted to delineate who fell within the purview of "insider trading" and reiterated the holding of *Chiarella* that a duty to disclose can only exist if there is a "specific relationship between the shareholders and the individual trading on inside information." *Id.* at 655, 103 S.Ct. at 3261. To find a derivative breach, there must have been a breach by a corporate insider of a duty owed to the company's shareholders about which the tippee knew or should have known. *Id.* at 660, 103 S.Ct. at 3264. In its famous footnote fourteen, the *Dirks* Court explained that a certain category of temporary insiders, or quasi–insiders, such as lawyers and accountants, would also have such a duty: "For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed non–public information confidential, and the relationship must imply such a duty." *Id.* at 655 n. 14, 103 S.Ct. at 3261 n. 14.

To find *Dirks* controlling would be to find no securities violation here, since Winans was not a temporary insider, did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information. In terms of the securities laws, neither Winans nor the Wall Street Journal owed any duties at all to the corporations that were the subject of *Heard* columns or to the shareholders of those corporations. However, the duties that *Dirks* addressed are not the ones under scrutiny in *Newman, Materia* or here. *Dirks* simply did not address the misappropriation theory, the Court having found that Dirks did not "misappropriate or illegally obtain the information." *Id.* at 665, 103 S.Ct. at 3267; *see also Bateman Eichler, Hill Richards, Inc. v. Berner*, ___U.S.___, ___, 105 S.Ct. 2622, 2630, 86 L.Ed.2d 215 (1985).

The *Dirks* case outlined the contours of one type of insider trading, where a corporate insider or his tippee perpetrates a fraud on the shareholders in breach of a corporate duty. That Newman or Materia might have been prosecuted as footnote fourteen insiders does not undermine the Second Circuit's misappropriation analysis, which focuses on the employer/employee fraud, an entirely different relationship from the one at issue in *Dirks*. *Materia* was decided after *Dirks*, and the absence of any discussion of the case leads us to conclude that the Circuit did

not believe that the tipper/tippee approach was relevant to the misappropriation theory.[8]

The essential point is that the misuse of corporate inside information is not the only type of fraud that the securities laws cover, which was made clear in *Materia*:

> We hold that such activity falls squarely within the "fraud or deceit" language of the Rule. Legislative history to the Securities Exchange Act of 1934 makes clear that the antifraud provision was intended to be broad in scope, encompassing all "manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S. Rep. No. 792, 73d Cong., 2d Sess., 6 (1934). This language negates the suggestion that the provision was aimed solely at the eradication of fraudulent trading by corporate insiders.

745 F.2d at 201. It is not accurate to say that *Dirks* wrote the book on insider or outsider trading; it wrote one chapter with respect to one type of fraudulent trading. That type is not before us. [9]

Nor do we believe that the misappropriation theory hearkens back to the "parity of information" doctrine, which has been rejected by the Supreme Court. That doctrine states in essence that all investors should have relatively equal access to

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8. On March 13, 1985, the SEC filed a Notice of Motion for Leave to Participate as Amicus Curiae, with an accompanying Memorandum of Law in Opposition to the Defendants' Motions for Acquittal. We hereby grant the motion. One of the points that the SEC makes is that the Commission addressed *Dirks* in its brief to the Second Circuit in *Materia*. The government also states that Materia made *Dirks*–based arguments in his brief to the Second Circuit.

9. The misappropriation theory has been found to support an indictment involving the tipping of corporate inside information. In *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y. 1985), there was no allegation that the corporate insider tipped his son for personal gain. Since such a finding is essential to *Dirks*' derivative liability, that case's analysis was inapplicable. Nonetheless, Judge Ward upheld the indictment on the misappropriation theory.

material information in order to preserve the market's integrity. Brudney, "Insiders, Outsiders, and Informational Advantages under the Securities Laws," 93 Harv. L. Rev. 322, 339 (1979). *Chiarella's* holding that "a duty to disclose under Section 10(b) does not arise from the mere possession of non-public market information" clearly rejects any approach based on a mere informational advantage. 445 U.S. at 235, 100 S. Ct. at 1118; see also *Dirks*, *supra*, 646 U.S. at 657, 103 S.Ct. at 3262. The *Chiarella* majority also did not accept the view that an informational advantage which is not "legally available to others," known as the access to information theory, should be the basis for drawing the line. 445 U.S. at 235 n.20, 100 S. Ct. at 1118 n.20; *see also Dirks*, *supra*, 463 U.S. at 672, 103 S. Ct. at 3270. But we do not agree that the misappropriation theory is in conflict. The focus of the approach before us is not whether the defendant had an informational advantage that *others* could not legally obtain, but on how the defendant gained the advantage, which must be fraudulently.

To look at conduct rather than information is actually quite consistent with *Dirks*, in which the Supreme Court also held that a corporate insider only breaches a duty to shareholders if he or she personally benefits from the disclosure. In support of that point (which was sharply disputed by the dissenters), a statement by SEC Commissioner Smith was approvingly quoted: "It is important in this type of case to focus on policing insiders and what they do . . . rather than policing information per se and its possession." *Dirks*, *supra*, 463 U.S. at 662–63, 103 S. Ct. at 3265.

What made the conduct here a fraud was that Winans knew he was not supposed to leak the timing or contents of his articles or trade on that knowledge. He knew that these columns were likely to affect the price of the stocks to his benefit. This is true even if he had not known of a written policy; he had knowledge of a Wall Street Journal practice, that is, a rule of conduct, which makes this a clear breach of a fiduciary duty. The government concedes that without any policy, there could be no prosecution under the misappropriation theory. We are not entirely sure that such a concession was necessary, but we understand it to mean that, if the Wall Street Journal could not show that it had set out the rules, it could not be said that

Winans had breached any duty. The contention that criminal liability cannot be premised on as broadly-stated and aspirational a set of guidelines as the Dow Jones policy is just not persuasive. While the policy itself tries to cover many ethical grey areas, and it may be difficult to tell whether some conduct fits within the guidelines, this case does not present any such problems. Winans breached the policy and he knew he was breaching it.

Nor do we find the fact that criminal liability is being premised on corporate internal policy unprecedented. The indictment in *Newman* charged the defendants with "violating the fiduciary duties of honesty, loyalty and silence owed directly to [the investment banking firms], and clients of those investment banks," duties as broadly phrased as any found in the conflicts policy. 664 F.2d at 16. Similarly, Materia's fraud was the violation of a company policy, and the fraud was defined as a breach of a fiduciary duty. *Materia*, *supra*, 745 F.2d at 203. In the mail fraud context, the question of criminal liability premised on internal corporate policy has been addressed directly, and endorsed, rather than found troublesome:

> Our discussion is not to be construed as holding that an employee's duty to disclose material information to his employer must be imposed by state or federal statute. Indeed, the employment relationship, by itself, may oblige an employee not to conceal, and in fact to reveal, information he has reason to believe is material to the conduct of his employer's business.

United States v. Von Barta, 635 F.2d 999, 1007 (2d Cir. 1980), *cert. denied*, 450 U.S. 998, 101 S. Ct. 1703, 68 L.Ed.2d 199 (1981). Even if we could accept newspaper articles as definitive proof that other newspapers do not have similar policies, that would not change the result in this case, where we are dealing with a specific employment relationship.[10]

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10. On January 21, 1985, the Reporters' Committee for Freedom of the Press, the National Association of Broadcasters, the Newsletters Association, the New York Financial Writers Association, the Media Institute, the Newspaper Guild, the Radio-Television News Directors Association, the

Counts Twenty–Six through Forty–Three charge the defendants with wire fraud in violation of 18 U.S.C. § 1343. The same trades form the basis for Counts Forty–Four through Sixty–One in violation of 18 U.S.C. § 1341, the mail fraud statute.[11] The parallel language of both statutes has led courts to give them both the same construction. *Von Barta*, *supra*, 635 F.2d at 1005 n.11. For ease of discussion, we will only refer to the mail fraud charges.

These "seemingly limitless provisions," *id.* at 1001, prohibit the use of the mails to execute "any scheme or artifice to defraud or for obtaining money or property by means of false or fraudulent pretense, representations or promises," 18 U.S.C. § 1341.[12] While the language of the statutes may be broad, the

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American Society of Magazine Editors, the National Newspaper Association, and the Associated Press Managing Editors filed a motion for leave to file a brief as amici curiae in support of defendants' Rule 29 motion to dismiss various counts of the indictment. They filed another motion for leave to file a supplemental memorandum on April 23, 1985. Because of the timing of the latter motion, we did not require the government to respond to the points raised. However, we hereby grant both motions.

The arguments made by the amici with respect to the proper construction of the securities laws are adequately addressed in the text. Amici make a more narrow argument that states in essence that the government's theory rests on ill–defined duties for reporters and editors; criminalization of breaches of those duties will interfere with the editorial process and will create a threat to the amici's First Amendment freedoms. We are not persuaded that the government's theory does create any new duties; as the government stated in their reply brief, "this prosecution under the 'misappropriation' theory creates no obligations, but merely enforces pre–existing obligations as it finds them." Nor does the theory impose any duties at all on publishers and editors as to what they must do if a reporter does disclose trading or tipping. Editors must make decisions about whether or not to run articles all the time, and this theory does not affect that choice at all. If Winans were to have disclosed to his editors prior to publication the fact that he was trading in the stock slated to be the subject of a *Heard* column the following day, the editors had several choices open to them, including running the column and taking disciplinary action against Winans for his misconduct, as well as seeking criminal penalties.

11. The government dropped Count 40 as to Carpenter and Felis, Count 43 as to Felis, and Counts 58 and 61 as to Carpenter and Felis.

12. Defendants acknowledge that "[i]ntangibles such as 'confidential and nonpublic commercial information' fall within the definition of 'property'

government's theory of the case follows two specific routes of analysis. First, the government argues that Winans' conduct constituted an abuse of his employers' confidences, and under one line of cases meets the requirements of a fraudulent scheme for that reason alone. *Haas v. Henkel*, 216 U.S. 462, 30 S. Ct. 249, 54 L.Ed. 569 (1910); *United States v. Hasenstab*, 575 F.2d 1035 (2d Cir.), *cert. denied*, 439 U.S. 827, 99 S.Ct. 100, 58 L.Ed.2d 120 (1978); *United States v. Girard*, 601 F.2d 69 (2d Cir.), *cert. denied*, 444 U.S. 871, 100 S.Ct. 148, 62 L.Ed.2d 96 (1979); *Abbott v. United States*, 239 F.2d 310 (5th Cir. 1956); *United States v. Kent*, 608 F.2d 542 (5th Cir.1979), *cert. denied*, 446 U.S. 936, 100 S.Ct. 2153, 64 L.Ed.2d 788 (1980); *United States v. Buckner*, 108 F.2d 921, 924–25 (2d Cir.), *cert. denied*, 309 U.S. 669, 60 S.Ct. 613, 84 L.Ed. 1016 (1940); *United States v. Groves*, 122 F.2d 87, 90 (2d Cir.), *cert. denied*, 314 U.S. 670, 62 S.Ct. 135, 86 L.Ed.536 (1941). Alternatively or additionally, the government argues that the fraud was Winans' breach of a fiduciary duty owed to the Wall Street Journal, when he had a duty to disclose both the leaks and his own trading to his employer. *Von Barta*, *supra*, 635 F.2d 999; *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981), *cert. denied*, 456 U.S. 915, 102 S.Ct. 1769, 72 L.Ed.2d 174 (1982); *United States v. Margiotta*, 688 F.2d 108 (2d Cir. 1982), *cert. denied*, 461 U.S. 913, 103 S.Ct. 1891, 77 L.Ed.2d 282 (1983); *United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983); *United States v. Weiss*, 752 F.2d 777 (2d Cir. 1985).

On the facts of this case, these theories overlap and become virtually indistinguishable. Winans' disclosures can only be seen as an abuse of his employers' confidences since he owed a fiduciary duty to the Wall Street Journal not to disclose the contents of the column in advance. Analogous facts tested the theory in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), a case already discussed in connection with the

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under the mail fraud statue." *United States v. Newman*, 664 F.2d 12, 19 (2d Cir. 1981) (quoting *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896, 99 S. Ct. 257, 58 L.Ed.2d 243 (1978)). Nonetheless, they object to that construction in light of the absence of any express ruling by the Supreme Court on the issue.

securities counts. In reversing the district court's dismissal of the indictment, the Second Circuit found the indictment's charges of fraudulent misappropriation of confidential information and the failure to disclose material information where there was a fiduciary duty to do so "a sufficient averment of wrongdoing" under the mail fraud statute and the applicable case law. *Id.* at 19–20.

Defendants argue that the mere breach of a fiduciary duty or an employee's failure to honestly serve his employer cannot serve as the basis for a mail fraud prosecution. *Weiss*, *supra*, 752 F.2d 777; *Siegel*, *supra*, 717 F.2d at 14. However,

> [t]he additional element which frequently transforms a mere fiduciary breach into a criminal offense is a violation of the employee's duty to disclose material information to his employer.

Von Barta, *supra*, 635 F.2d at 1006; *see also Weiss*, *supra*, 752 F.2d 777; *Siegel*, *supra*, 717 F.2d 9. This is not a case in which the government can be accused of bootstrapping a duty to disclose onto a fiduciary duty. Even Winans' admission that he knew that what he was doing violated a "practice," which if discovered would result in his dismissal, leads inexorably to a finding that he breached a fiduciary duty. His conduct also establishes his awareness that he had a duty not to disclose the content and timing of publication of the column as well as a duty to disclose, at the very least, any leaks of the column.

The argument that Winans' theft of confidential information was not necessarily a fraud fails because of the existence of a duty to disclose.[13] It is entirely irrelevant that he did not have

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13. It is a bit absurd to say that an element of Winans' crime was that he did not tell the Wall Street Journal he was committing it. But, what distinguishes our case from a "mere breach of a fiduciary duty" is the same element that existed in *Newman*: "[t]he scheme included breach of the employees' fiduciary duties by material misrepresentations to the employer and non-disclosure of material information required to be disclosed." *Newman*, *supra*, 664 F.2d at 19. Winans may not have made any material misrepresentations to his employer before the SEC investigation, but he knew all along that the Journal cared about leaks. The scheme was also a fraud and not a "mere theft" because the scheme's "'object was to filch from [the employer]

to break into any locked files to find out when his own articles were going to run. Whatever ambiguities may lurk in the language of the Dow Jones Conflicts of Interest Policy, the activity Winans participated in did not fall between any of the cracks. Even if Winans' testimony is accepted in its entirety, he did not have to be aware of the existence of a Conflicts of Interest Policy, much less a written one, to know that his activities violated a practice, were unethical and would lead to dismissal. The level of notice required to let an employee know that his conduct would amount to a breach of a fiduciary duty has been accepted on much weaker facts than these. *Von Barta, supra*, 635 F.2d at 1002 (high–level employee with a great deal of discretion verbally admonished "never to jeopardize the firm's banking relationships" and always to advise his employer if the firm's repurchase agreements "were in trouble").

Other elements of the mail fraud counts are also contested. The government must prove "that some actual harm or injury [to the scheme's victims] was at least contemplated." *Von Barta, supra*, 635 F.2d at 1006 n.14. It need not be proven or alleged that the victim was actually defrauded, since the statutes forbid a scheme to defraud and not actual fraud. *United States v. London*, 753 F.2d 202, 205 (2d Cir. 1985). Like the securities counts, the mail fraud charges rest on the theory that the Wall Street Journal was the victim of the fraud. The harm suffered was an alleged reputational injury; as a result of having a reporter engaged in such unethical conduct, the Wall Street Journal's reputation for journalistic integrity was sullied. Defendants argue that there was no harm to the alleged victim as a matter of fact, and that reputational injury is too nebulous and ill–defined to support a mail fraud violation.

As to the question of whether the Wall Street Journal's reputation suffered as a result of this matter, the point is not revelant. Defendants questioned a number of witnesses about their perceptions of the Journal's reputation and introduced evidence relating to the financial success of the newspaper in the past year. Government witnesses also testified to their views of

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its valuable property by dishonest, devious, reprehensible means.'" *Id.* at 19 (quoting *Abbot v. United States*, 239 F.2d 310, 314 (5th Cir. 1956)).

the newspaper's reputation; they recited anecdotes about strained relationships with sources and complaints from readers about reporters "on the take." Obviously, whatever reputational damage occurred in connection with the events of this trial, the Wall Street Journal has not been driven out of business.

All that must be shown is that "some harm or injury was contemplated by the alleged scheme." *London, supra*, 753 F.2d at 206; *see also Siegel, supra*, 717 F.2d 9. Further, "[harm or injury] may be inferred 'when the scheme has such effect as a necessary result of carrying it out.'" *London, supra*, 753 F.2d at 206 (quoting *United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1181 (2d Cir. 1970)). The scheme's injurious consequences to the Journal must have been known to Winans. It is obviously untenable to argue, as the defendants do, that since the conspirators never intended to get caught, they could not have contemplated that the Wall Street Journal would be harmed.

In the most relevant case law, the misappropriation of confidential information has virtually been presumed to be injurious to the employer whose confidence is betrayed. *See Materia, supra*, 745 F.2d 197; *Newman, supra*, 664 F.2d 12. Defendants distinguish those cases on the ground that the injury to reputation in those circumstances was premised on the contractual relationship between the employer and the employer's client; that is, the corporate clients who entrusted their takeover and merger plans to investment banking firms and printers are necessary third parties to make the reputational injury fly. We fail to see the significance of that distinction for the reasons already discussed in the securities law section.

Moreover, the fraudulent misappropriation or theft of the WSJ's property is in itself sufficient to satisfy the requirement of contemplation of harm. The theft of valuable property is of course a crime even if the victim is unaware of the loss. Here, the fraudulent taking and misuse of the confidential information stolen from the WSJ placed immediately in jeopardy probably its most valuable asset—its reputation for fairness and integrity. These conspirators, with their intimate knowledge of the financial and stock markets and of the influential role that the *Heard* column played in these markets, were hardly

unaware of the potentially devastating harm that their fraudulent acts could cause to the WSJ.

All of the defendants assert that the mailing and wiring of Winans' articles is an insufficient jurisdictional basis for the mail and wire fraud counts. The mailing requirement is another limitation placed on the breadth of the statutes:

> The federal mail fraud statute does not purport to reach all frauds, but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law.

Kann v. United States, 323 U.S. 88, 95, 65 S.Ct. 148, 151, 89 L.Ed. 88 (1944). The use of the mails must be "incident to an essential part of the scheme." *Pereira v. United States*, 347 U.S. 1, 8, 74 S.Ct. 358, 363, 98 L.Ed. 435 (1954). Moreover, one "causes" the mails to be used "[w]here one does an act with knowledge that the use of the mails will follow in the ordinary course of business or where such use can reasonably be foreseen, even though not actually intended." *Id.* at 8–9, 74 S.Ct. at 362–363.

The defendants argue that the telexing of articles for printing and the mailing of the Wall Street Journal to subscribers were legitimate, routine and inevitable uses of the wires and mails, wholly unaffected by Winans' trading activity. Whether or not Winans wrote a Heard on the Street column, and whether or not he provided leaks to Brant about the column, the Wall Street Journal would have been published every day. Moreover, they argue that Winans was required to write his articles for publication as a condition of his employment; he fulfilled that obligation by writing his "journalistically pure" columns.

Defendants primarily rely on a Third Circuit case, which held that the mailing of packing slips with phonographic records was an insufficient basis for a mail fraud charge. *Tarnopol v. United States*, 561 F.2d 466, 472 (3d Cir.1977). While there is language in the opinion dealing with the routine nature of the business mailings at issue, the case did not create any per se rule for routine business mailings. Rather, as the Third Circuit subsequently explained:

> [*Tarnopol*] merely applied the already established notion that mailings which are too remote from a fraudulent scheme will not support a mail fraud charge.

United States v. Brown, 583 F.2d 659, 667 (3rd Cir.1978), *cert. denied*, 440 U.S. 909, 99 S.Ct. 1217, 59 L.Ed.2d 456 (1979). The packing slips of *Tarnopol* were not only legitimate and routine mailings, but were also entirely unrelated to the scheme. In fact, the court noted that "the fraud would have been better served if no packing slips had been in existence." *Tarnopol, supra*, 561 F.2d at 473.[14]

Here, however, the publication and distribution of the Wall Street Journal was an integral part of the scheme to defraud. While defendants argue that the mailings were *unaffected* by the fraud, they do not, and cannot assert that the mailings were *unrelated* to the scheme, which is the proper focus. The fact that an innocent third party actually made the jurisdictional communication is of no consequence, since the wirings and mailings were reasonably foreseeable. *United States v. Muni*, 668 F.2d 87, 89 (2d Cir.1981). This is hardly a situation where the nexus between the mailings and wirings and the alleged fraud is too remote; without publication and distribution of the copies of the Journal containing the columns in question there would be no point to the scheme.[15]

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14. Nor is this case anything like *Parr v. United States*, 363 U.S. 370, 80 S.Ct. 1171, 4 L.Ed.2d 1277 (1960) where the mailing of a tax bill was held to be insufficient to substantiate a mail fraud charge, even though the defendants subsequently embezzled the proceeds. The legal mandate compelling the mailings in *Parr* is not analogous to Winans' employment requirements. In *Parr*, the Court noted that "the factual situation is unique," *id.* at 391, 80 S.Ct. at 1183, that is, the mailing in question was required by law. Moreover, the Court relied substantially on the fact that the indictment did not allege that the mailings were part of the offense. *Id.* at 392, 80 S.Ct. at 1184.

15. Testimony from Daniel Hinson, an Assistant Managing Editor of the WSJ, Richard L. Graff, an Associate National Circulation Service Manager at Dow Jones & Co. and Kenneth Rodin, a general supervisor at the U.S. Postal Service established that these stories were transmitted by telecopier from the Wall Street Journal at 22 Cortlandt Street, New York, New York to Chicopee, Massachusetts and elsewhere for printing in the newspaper.

The government must also establish that the defendants acted with specific intent, a discussion equally applicable to the mail, wire and securities fraud counts. *Dirks, supra*, 463 U.S. at 663 n. 23, 103 S.Ct. at 3265 n. 23. As the Second Circuit stated:

> This specific intent requirement is sometimes used to distinguish actual and constructive fraud. Actual frauds are intentional frauds. Constructive frauds involve breaches of fiduciary or equitable duties where intent to deceive is lacking. Only actual frauds are within the purview of the mail fraud statute.

Von Barta, supra, 635 F.2d at 1005 n. 14 (citations omitted). The basic definition of this term is

> To act with "intent to defraud" means to act knowingly and with the specific intent to deceive ordinarily for the purpose of either causing some financial loss to another, or bringing about some financial gain to one's self.

2 Devitt & Blackmar, Federal Jury Practice and Instructions §47.08 (3d ed. 1977); Sand, Modern Federal Jury Instructions ¶44.01 (1984); *United States v. Niro*, 338 F.2d 439, 440 n.2 (2nd Cir.1964).

The essence of the defendants' argument is that to have intended to defraud the Wall Street Journal, each defendant would have to know the specifics of the conflicts of interest policy. Their argument goes so far as to say that each defendant had to know the precise language of the written conflicts policy that was being violated.

We do not agree that the specific intent requirement is meant to be quite that specific. Nor do we believe that such a precise knowledge of what type of wrong Winans was committing at the Journal is necessary to show that any defendant aided and abetted the fraud. The government is not required to

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The newspapers are also mailed to some 22,000 subscribers in the Southern District of New York.

prove actual knowledge by each defendant, of every detail that made the scheme a fraudulent one. Nor is the government required to show that the defendants intended to violate the law, since ignorance of the law is no defense. *See, e.g., United States v. Gregg*, 612 F.2d 43, 50 (2d Cir.1979); *United States v. Berardelli*, 565 F.2d 24, 30 (2d Cir.1977).

Our focus is on whether the defendants intended to deceive the Journal, or aided and abetted Winans in his efforts to deceive the Journal. The defendants need not have known about every particular of the conflicts of interest policy to have knowledge that the Wall Street Journal was being defrauded by Winans for his own financial gain.

With respect to the mail and wire fraud counts (as well as the securities fraud counts), good faith would be a complete defense: the burden is on the government to show lack of good faith beyond a reasonable doubt. *United States v. Bronston*, 658 F.2d 920, 930 (2d Cir.1981), *cert. denied*, 456 U.S. 915, 102 S.Ct. 1769, 72 L.Ed.2d 174 (1982). This defense is raised by Felis, who asserts that he never believed that this arrangement was illegal. He relies, in part, on a conversation with Brant, although Felis knew that Clark was the source of that legal opinion. He also relies on the conversation with Krantz.

Reliance on the advice of counsel is not an absolute defense, but is one factor to be considered in assessing good faith and intent. *United States v. Financial Committee to Re-Elect the President*, 507 F.2d 1194 (D.C.Cir.1974). Essential to any claim based on reliance on counsel is that the attorney must have been fully informed of all the relevant facts. *United States v. Stirling*, 571 F.2d 708, 735 (2d Cir.), *cert. denied*, 439 U.S. 824, 99 S.Ct. 93, 58 L.Ed.2d 116 (1978); *United States v. King*, 560 F.2d 122, 132 (2d Cir.), *cert. denied*, 434 U.S. 925, 98 S.Ct. 404, 54 L.Ed.2d 283 (1977). It is also a difficult argument to make when the attorney whose advice was relied on was a participant in the scheme: in such a case, "legal assurance was not sought because acting within the framework of the law was not the reason appellants elected to deal with members of the Bar." *United States v. Shewfelt*, 455 F.2d 836, 839 (9th Cir.), *cert. denied*, 406 U.S. 944, 92 S.Ct. 2042, 32 L.Ed.2d 331 (1972). Any attorney whose advice is later used to

establish good faith must have been "unbiased and competent." *Financial Committee, supra*, 507 F.2d at 1198.

Defendants also argue that this criminal prosecution offends the Due Process clause, since they lacked fair notice of the criminality of their conduct. As the Second Circuit has stated,

> All the Due Process clause requires is that the law give sufficient warning that men may conduct themselves so as to avoid that which is forbidden, and thus not lull the potential defendant into a false sense of security, giving him no reason even to suspect that his conduct might be within its scope.

United States v. Herrera, 584 F.2d 1137, 1149 (2d Cir.1978). There need not be any litigated fact pattern directly on point. *United States v. Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir.), **cert. denied**, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983). The fair notice argument has been repeatedly rejected in the Rule 10b–5 context on a wide variety of fact patterns. *Newman, supra*, 664 F.2d at 18–19; *Chiarella*, 588 F.2d at 1369; *United States v. Brown*, 555 F.2d 336, 339–40 (2d Cir.1977); *United States v. Persky*, 520 F.2d 283, 286–88 (2d Cir.1975); *SEC v. Shapiro*, 494 F.2d 1301, 1308 (2d Cir.1974). Defendants' numerous deceptive acts hardly support the notion that they had no idea that they were committing a wrongful act. As the Circuit remarked in *Newman*, "[i]n other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful," and defendants "would have had to be most ingenuous to believe that Congress intended to establish a less rigorous code of conduct under the Securities Acts." *Newman, supra*, 664 F.2d at 18.

III

We conclude as follows. The conspiracy began on October 16, 1983, when Winans and Brant agreed to trade on advance information concerning the timing and content of Wall Street Journal articles. Felis was promptly informed by Brant of the arrangement and agreed to participate. The three of them continued as active participants in the conspiracy to defraud and to obstruct justice when the SEC began its investigation in March 1984. The evidence which we have reviewed in detail above establishes beyond any doubt the fraudulent scheme, to which each of them knowingly and wilfully subscribed. With the exception of the first three trades (relating to American Surgery and Institutional Investors) listed in the indictment as overt acts, each of the remaining overt acts were committed by a conspirator in the Southern District of New York at the time alleged in furtherance of the conspiracy.

We find that Carpenter never joined the conspiracy with Winans, Brant and Felis. He initially had a vague understanding of a business arrangement between the three; the nature of that arrangement became clearer to him over time, and by the end of the year he was fully aware of what was going on. We are loathe to dwell on Carpenter's "spousal relationship" defense, since it carries with it assumptions about spousal roles which would only be true for the most subservient spouse. Nevertheless, the government has not shown beyond a reasonable doubt that Carpenter ever reached any agreement with the other conspirators. The arrangement was never substantively discussed in his presence, his participation was never sought until the last month, and, with the exception of Brant's gift of travel money, Carpenter was never given a share of the profits distinct from Winans' share. He was treated as Winans' uninvolved spouse, consistent with the nature of their relationship; he did not act as a conspirator, nor was he perceived as such by Winans, Brant or Felis.

Nor was the role played by Carpenter in the last month of the scheme, when the SEC began its investigation, that of a conspirator. He primarily acted as a messenger boy between Winans and Brant and Felis. There is no question that he produced the fake invoices. However, Carpenter stalled

repeatedly before finally producing the invoices under substantial pressure from Brant and Felis. They were also done so badly that Carpenter's handiwork may well have been a deliberate failure to comply with any plan to obstruct justice. Indeed, those invoices were never used to thwart the SEC investigation, but were revealed to the SEC by Carpenter himself at the time of his voluntary testimony. In short, he was at no time a willing participant in any aspect of the conspiracy.

We do not find Felis' assertions of good faith believable. He argues that he never believed the trading arrangement to be illegal or improper except from a Kidder Peabody "appearance" point of view. This is said to explain Felis' lies to Kidder Peabody executives and his trip to Switzerland to open the Western Hemisphere account. However, while Brant did tell Felis that the arrangement was legal at the time of its inception, Felis was aware that the source of this legal advice was David Clark. Not only was Clark a participant in the scheme, but Felis' own witness, Casey Enright, testified that she and Diane Hackett told him not to trust Clark.

Nor can Felis rely on the meeting with Krantz, in which Krantz expressed some confusion about the Supreme Court's recent pronouncements on insider trading. Krantz did not have all the material facts, since Brant and Felis had lied to him, and he never stated that trading on advance information from the WSJ was not illegal. The testimony of Brant's and Felis' assistants that Brant, Felis and Krantz emerged from that meeting all smiles, is fully consistent with what happened at that meeting. Krantz thought the problem was solved by Clark's decision to move his trading and Brant and Felis thought the problem was solved because Kidder Peabody was satisfied that they were doing nothing illegal. Felis' conduct throughout demonstrates that he was a willful and knowing participant in what he understood was an unlawful venture.

As to the securities counts, Winans and Felis employed devices, schemes and artifices to defraud and engaged in acts, practices and a course of business which operated as a fraud and deceit on the Wall Street Journal and Dow Jones & Co., Inc. Each did so by means and instrumentalities of interstate commerce, the mails and facilities of national securities

exchanges in connection with the purchase of sale of securities alleged in the securities counts.[16] We find that Winans and Felis, together with Brant, each had the requisite specific intent to defraud.

Carpenter, although not a conspirator, did aid and abet the scheme. During his one and a half years at the WSJ, he became aware of the rules of the game and consequently knew that what Winans was doing was fraud on the WSJ. He endorsed the checks made out to him by Brant or Felis, allowed Winans to trade in his name in the Merrill Lynch and Schwab accounts, and to that extent willfully participated in the criminal venture and helped it succeed.

We make no distinctions between the various counts, finding none of the defendants' distinctions persuasive. It makes no difference that one transaction was charged as mail and wire fraud, but not as securities fraud, or that the government combined trades in two different accounts in some counts, but charged those transactions separately in others. Nor does it make a difference that some of these transactions resulted in losses. *Materia* does require that the trading be to the defendant's "own advantage," but that language speaks to the intent requirement insofar as the misappropriator must have been motivated by personal gain; we do not agree that the misappropriator must have made a profit on each transaction. Moreover, all of these trades were pursuant to a long-term plan. The three losing trades show that the venture was not entirely risk-free, but there is no doubt that the arrangement was very profitable as a whole. Lastly, there is no principled distinction between columns written by someone other than Winans or articles other than *Heard* columns; the crime was in the disclosure of the newspaper's contents and the trading on the basis thereof.

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16. Winans and Felis, as parties to the conspiracy, are each responsible for the substantive offenses committed by a co-conspirator in furtherance of the conspiracy, regardless of any participation in the substantive offense or any actual knowledge of that offense. *Pinkerton v. United States*, 328 U.S. 640, 645-48, 66 S.Ct. 1180, 1183-85, 90 L.Ed. 1489 (1946).

As to mail and wire fraud counts, Winans and Felis devised and participated in a scheme and artifice to defraud the Wall Street Journal and to obtain money and property of the WSJ by means of false and fraudulent pretenses and representations. Once again, Carpenter aided and abetted the scheme to the extent charged in the indictment. Each defendant, by virtue of the scheme itself, contemplated harm to the Journal's reputation. Winans caused the jurisdictional mailings and wirings by submitting them for publication after leaking them to Brant and Felis.

Accordingly, we find defendant Winans guilty on Counts 1 through 18, 20 through 24, and 26 through 61, inclusive, as charged in the superseding indictment. We find David Carpenter guilty on Counts 14, 17, 18, 21, 22, 24, 38, 41, 42, 56, 59 and 60. Lastly, we find defendant Felis guilty of Counts 1 through 13, 15, 16, 20, 23, 26 through 33, 36, 37, 39, 41, 44 through 51, 54, 55, 57 and 59. Dates for sentencing will be determined in consultation with counsel.

SO ORDERED.